

The Sales Tax and Capital Transactions

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As early as 1934, when the sales tax was coming into prominence as a major source of revenue in many states, it was observed:¹

If, as seems likely, sales taxes remain in force for some years in many of the states, there will develop a new body of tax law [which], although perhaps not inherently as complex as that of the income tax, will nevertheless rival it in affording opportunity for error and litigation.

The tax has remained and its demise cannot be anticipated in the foreseeable future.² Today, in one form or another,³ it is in effect in approximately two-thirds of the states⁴ and in a number of cities.⁵ As with any other law that reaches into the pocketbook, litigation has been bountiful and the predicted "new body of tax law" is emerging. However, when compared with the income tax, the sales tax is still in its infancy; the full scope of its impact on various transactions is as yet undetermined. One of the virgin areas is that of the applicability of the sales tax to the formation, reorganization, and liquidation of business enterprises.

Two recent California cases are of immense significance because they may serve as the gateway to this unexplored area. First in *Market Street*

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¹ Shoup & Haimoff, *The Sales Tax*, 34 COLUM. L. REV. 809, 830 (1934). The sales tax in the United States had its greatest impetus during and after the depression as an emergency measure to provide new revenue sources. See HAIG & SHOUP, *THE SALES TAX IN THE AMERICAN STATES* 7-8 (1934); JACOBY, *RETAIL SALES TAXATION* 75-77 (1938); Due, *The Nature and Structure of Sales Taxation*, 9 VAND. L. REV. 123, 127 (1956). For a comprehensive discussion of the history of the sales tax in various states, see HAIG & SHOUP, *op. cit. supra*. For a history of the California retail sales and use tax, see REPORT OF CAL. SENATE INTERIM COMMITTEE ON STATE AND LOCAL TAXATION, *STATE AND LOCAL TAXES IN CALIFORNIA: A COMPARATIVE ANALYSIS* 35 (1951). For a bibliography on the multifarious aspects of the sales tax, see Cline, *The Literature of Sales Taxation*, 9 VAND. L. REV. 360 (1956).

² During 1954-55, the sales and use tax produced a revenue of approximately 492.9 million dollars for the State of California; it was the largest source of tax revenue, accounting for 37.9% of the total. REPORT OF CAL. SENATE INTERIM COMMITTEE ON STATE AND LOCAL TAXATION, *STATE GOVERNMENT FINANCE IN CALIFORNIA* 44 (1957).

³ For a classification of the different types of "sales tax", see HAIG & SHOUP, *THE SALES TAX IN THE AMERICAN STATES* 3-4 (1938).

⁴ See Due, *The Nature and Structure of Sales Taxation*, 9 VAND. L. REV. 123, 127 (1956); Northrup, *The Measure of Sales Taxes*, 9 VAND. L. REV. 237, 238 (1956) (appendix includes citations to various state statutes). For a brief survey of the sales tax in various states, see R. & G. Blakey, *State Sales and Use Taxes*, 20 TAXES 155, 223 (1942).

⁵ In California alone 162 cities imposed a sales tax in 1953. See Pierce, *California Has a Sales Tax Headache*, 6 NAT'L TAX J. 168, 169 (1953). Under the Bradley-Burns Uniform Local Sales and Use Tax Law, CAL. REV. & TAX CODE §§ 7200-07, enacted in 1955, counties in California have been authorized to adopt sales and use tax ordinances.

Ry. v. California State Bd. of Equalization,⁶ and soon thereafter in *Sutter Packing Co. v. State Bd. of Equalization*,⁷ the California appellate courts have given their approval to the inclusion of the gross receipts from the sale of an entire business within the measure of the state sales tax.

Until the *Market Street* and *Sutter Packing* cases were decided, the sales tax consequence of a sale of an entire business was uncertain; the State Board of Equalization, the agency administering the California Sales and Use Tax Law, itself had vacillated on this issue.⁸ One objective of this paper is to discuss the development of the sales tax law relevant to the result in these two cases, consider the cases themselves, and post warning signs, borrowed from the Sales and Use Tax Law of California, for the planning and negotiation of a sale of an entire business. The second objective is to explore the taxability of transfers incident to formation and reorganization of various business enterprises and to distributions in kind.

The paucity of cases dealing with the taxability of a sale of an entire business is understandable since in many states the statutory occasional or casual sale exemption has been administratively interpreted in such manner as would exempt the sale of an entire business⁹ and in other states, even without such statutory exemption, the administrative practice would make its taxability unlikely.¹⁰ In some jurisdictions judicial interpretation

⁶ 137 Cal. App. 2d 87, 290 P.2d 20 (1955).

⁷ 139 Cal. App. 2d 889, 294 P.2d 1083 (1956), *hearing denied*, May 15, 1956.

⁸ Prior to October 1, 1944, Ruling 63 promulgated by the State Board of Equalization provided that the sales tax does not apply to "any portion of the consideration paid in connection with the sale of an entire business." On that date Ruling 63 was amended to provide that the "portion of the gross receipts from the sale of an entire business operated by a retailer that represents the fair retail value of the tangible personal property" must be included in the measure of the tax. The latter provisions have been amended and are now found in Ruling 81, 18 CAL. ADMIN. CODE § 2101.

⁹ The term "sale of an entire business" is loosely used as a matter of convenience to connote the sale of all or substantially all the assets in the business.

In many states express statutory provisions exempting occasional, isolated or casual sales have been administratively interpreted to exempt a sale of an entire business or to exempt sales of articles not regularly sold in the taxpayer's business, which in effect would exempt the transfer of items of property not regularly sold included within the sale of an entire business. *E.g.*, (a) FLA. STAT. § 212.02 (1955); Rule 37, CCH FLA. TAX REP. ¶ 60-225; (b) ILL. REV. STAT. c. 120, § 440 (1953) as amended, ILL. SESS. LAWS 2037 (1955); Reg. art. 1, CCH ILL. TAX REP. ¶ 60-206; (c) LA. REV. STAT. tit. 47, § 301 (1950); Reg. art. 2-33, CCH LA. TAX REP. ¶ 60-227; (d) PA. STAT. ANN. tit. 72, § 3407-102 (Purdon Supp. 1954); Reg. 202, CCH PA. TAX REP. ¶ 60-203.

¹⁰ In some states there is no statutory exemption for casual or occasional sales but the administrative regulations would seem to indicate that sale of an entire business by a retailer would not be taxed. *E.g.*, Conn.: Reg. No. 15, CCH CONN. TAX REP. ¶ 60-059; R.I.: CCH R.I. TAX REP. ¶ 63-853.

In other states, either a statute or regulation alludes to an isolated sale exemption but it is difficult to determine the scope: *e.g.*, ARK. STAT. § 84-1904 (1947); N.D.: Rule No. 42, CCH N.D. TAX REP. ¶ 60-055; OHIO REV. CODE ANN. § 5739.02 (Baldwin 1953).

In Indiana and Oklahoma there is no relevant exemption either in the statute or the regulations; thus, the rule is uncertain. IND. STAT. ANN. §§ 64-2601-64-2635 (Burns Supp. 1957); OKLA. STAT. tit. 68, §§ 1251a-51n (1951).

of the relevant sales tax provisions makes it unlikely that this issue will arise, or, if it does, that such sale will be held subject to the tax.¹¹ In the few cases considering the issue, the courts have thwarted the attempted expansion of the tax base by the inclusion of the sale of an entire business in the measure of the tax.¹² Although, in several states administrative interpretations indicate that such sales will be taxed,¹³ the *Market Street* case was probably the first to give judicial blessing to the taxation of the sale of an entire business.¹⁴

I

BASIC CONCEPTS

In order to evaluate the holding in the *Market Street* case one must understand the relevant statutory provisions and the prior cases which furnish the foundation for the decision.

The sales tax in California is imposed upon "retailers" for the privilege of making "retail sales," and the tax is measured by the gross receipts from "retail sales."¹⁵ Thus, the question whether *Market Street* was correctly assessed depended upon whether it was a "retailer" and whether the measure of the tax assessed included gross receipts from "retail sales" only. Because a "retailer" is defined in terms of "retail sales,"¹⁶ it is convenient to examine initially the legislative definition of a "retail sale."

¹¹ *E.g.*, *Geneva Steel Co. v. States Tax Comm'n*, 116 Utah 170, 209 P.2d 208 (1949) (a sale must be made in the regular course of business to be a taxable sale; separate sales of six or seven integrated businesses by the War Assets Administration did not make the agency a seller engaged in the business of making sales of integrated businesses); *M. L. Virden Lumber Co. v. Stone*, 203 Miss. 251, 33 So.2d 841 (1948) (incidental sales of property not regularly sold in the business are exempt); *Stone v. M. L. Virden Lumber Co.*, 205 Miss. 841, 39 So.2d 498 (1949) (same case); *Oklahoma Tax Comm'n v. Texas Co.*, 182 Okla. 91, 76 P.2d 389 (1938) (incidental sales of property not regularly sold in the business are exempt; subsequent to this case, a new statute was adopted; see note 13 *infra*).

¹² *Novak v. Redwine*, 89 Ga. App. 755, 81 S.E.2d 222 (1954); and its companion case, *State v. Dyson*, 89 Ga. App. 791, 81 S.E.2d 217 (1954); *Tawes v. Thompson Trailer Corp.*, 209 Md. 490, 121 A.2d 850 (1956); *Liberty Cash Grocers, Inc. v. Atkins*,Tenn., 304 S.W.2d 633 (1957); *Chesapeake Marine Ry. Co. v. Comptroller*, 1 P-H CAL. STATE AND LOCAL TAX SERV. ¶ 92,975.269 (Md., 1951); *California State Bd. of Equalization v. Goggin*, 191 F.2d 726 (9th Cir. 1951), *cert. denied*, 342 U.S. 909 (1952); *California State Bd. of Equalization v. Boteler*, 131 F.2d 386 (9th Cir. 1942) (liquidation sales by trustee in bankruptcy not subject to California sales tax).

¹³ *E.g.*, Colo.: Rule No. 18, CCH COLO. TAX REP. ¶ 60-107; Wyo.: CCH WYO. TAX REP. ¶ 60-120.15.

¹⁴ But *Palmer v. Perkins*, 119 Colo. 533, 205 P.2d 785 (1949) contains a dictum that a retail sale of an an entire business is subject to the sales tax.

¹⁵ CAL. REV. & TAX. CODE § 6051. The sales tax of California has its origin in The Retail Sales Tax Act of 1933, Cal. Stat. 1933, c. 1020, p. 2599 and was amended to its present form in 1949, Cal. Stat. 1949, c. 728, p. 1343.

¹⁶ Note 22 *infra*.

A. The Retail Sale

"A 'retail sale' or 'sale at retail' means a sale for any purpose other than resale in the regular course of business in the form of tangible personal property."¹⁷ As is apparent from this statutory definition, the purpose of the buyer in making the purchase is the determinative factor. If the principal purpose of the buyer is to use the property, rather than resell it, the sale is a retail sale.¹⁸ This is true even though the buyer might intend to resell the same property when he no longer has any use for it.¹⁹ But what effect is to be given to the phrase "in the regular course of business in the form of tangible property" which appears in the statutory definition of a "retail sale"? Arguably, the phrase could modify the sale by the retailer upon whom the tax is levied. Grammatically and logically, however, the phrase must modify the resale by the purchaser; a sale thus falls outside the definition of "retail sale" only if the buyer is planning to resell the property in the regular course his business in the form of tangible personal property.²⁰

¹⁷ CAL. REV. & TAX. CODE § 6007.

¹⁸ *People v. Puritan Ice Co.*, 24 Cal. 2d 645, 151 P.2d 1 (1944); *American Distilling Co. v. State Bd. of Equalization*, 55 Cal. App. 2d 799, 131 P.2d 609 (1942); *Chapman Chinchilla Sales Co. v. Johnson*, 49 Cal. App. 2d 195, 121 P.2d 69 (1942); *People v. Monterey County Ice and Development Co.*, 29 Cal. App. 2d 421, 84 P.2d 1069 (1938).

Where property is partially consumed in the process of manufacturing or production, many interesting and difficult problems arise with respect to the question whether the purchaser has purchased the tangible personal property for resale or for use. See, e.g., *American Distilling Co. v. State Board of Equalization*, 55 Cal. App. 2d 799, 131 P.2d 609 (1942). The test used by the State Board of Equalization is whether the raw material becomes "an ingredient or component part of the manufactured article." Ruling 14, 18 CAL. ADMIN. CODE § 1924. For a discussion of what constitutes a retail sale under the various sales tax acts, see Redlich, *Sales Taxes and the Resale Exemption in the Manufacture and/or Distribution of Personal Property*, 9 TAX L. REV. 435 (1954); Shoup & Haimoff, *The Sales Tax*, 34 COLUM. L. REV. 809 (1934); Wahrhaftig, *Meaning of Retail Sale and Storage, Use or Other Consumption*, 8 LAW & CONTEMP. PROB. 542 (1941). And for a discussion and criticism of the "pyramiding" of sales tax resulting from the imposition of tax on the sale of those articles which are not exempt as a sale for resale but which enter into the cost of goods sold by the purchaser, the ultimate consumer bearing not only the sales tax imposed on the sale to him but also the burden of the sales tax paid by the manufacturer or processor, see Frampton & Smith, *Commodities and Transactions Exempt from Consumption Taxes*, 8 LAW & CONTEMP. PROB. 579 (1941); Hellerstein, *The Scope of the Taxable Sale under Sales and Use Tax Acts: Sales as Distinguished from Services*, 11 TAX L. REV. 261 (1956); Macon, *Distinction Between Wholesale and Retail for Sales Taxation in North Carolina*, 12 TAXES 421 (1934); Redlich, *supra*.

¹⁹ *Kirk v. Johnson*, 37 Cal. App. 2d 224, 99 P.2d 279 (1940).

²⁰ CAL. REV. & TAX. CODE § 6007, defining a retail sale, and CAL. REV. & TAX. CODE §§ 6091-94, relating to the resale certificates given by the purchasers to the retailers as evidence of exempt sales, were amended simultaneously to include the restrictive phrase "in the regular course of business." Cal. Stat. 1939, c. 679, §§ 2(c), 11. Section 6092 presently provides that the seller is relieved of the burden of proving that sales were not retail sales only if the seller receives a resale certificate from his purchaser "who is engaged in the business of selling tangible personal property . . . and who, at the time of purchasing the tangible personal property, intends to sell

It is also important to note that there is nothing in the Sales and Use Tax Law which exempts a sale solely because a sales tax was once levied upon the gross receipts from a previous sale of the same property. Thus, for example, the retailers of used cars are subject to the sales tax even though the cars which they sell may have been subjected to the sales tax when sold new.²¹

B. The Retailer

The second statutory term to be examined is "retailer". Because a "retailer" is a person engaged in the business of making retail sales,²² there remains only the inquiry as to the meaning of "business".

it in the regular course of business or is unable to ascertain at the time of purchase whether the property will be sold or will be used for some other purpose."

If a buyer purchases a new truck for use in his retail hardware business with the intention of reselling when it becomes obsolete, the subsequent resale by the buyer is not, for the purpose of the original sale, in the regular course of the buyer's business. And if the buyer purchases an item of property for the purpose of resale in the regular course of his business, the original sale to him is a retail sale if upon resale by the buyer the property will be affixed to realty. See Ruling 11, 18 CAL. ADMIN. CODE § 1921. As to problems arising with respect to whether the purchaser, usually a building contractor, purchases the commodities to resell "in the form of tangible personal property", see Cohen, *The Taxable Transaction in Consumers' Taxes*, 8 LAW & CONTEMP. PROB. 530, 540 (1941); Hellerstein, *The Scope of the Taxable Sale under Sales and Use Tax Acts: Sales as Distinguished from Services*, 11 TAX L. REV. 261, 295 (1956); Wahrhaftig, *Meaning of Retail Sale and Storage, Use or Other Consumption*, 8 LAW & CONTEMP. PROB. 542, 555 (1941).

²¹ For a differing treatment of the problem of trade-ins in other states, see Ratchford, *The Measure of Consumption Taxes*, 8 LAW & CONTEMP. PROB. 561, 571 (1941).

Cries of double taxation have been raised with regard to the subsequent sale of "trade-ins" since the dealer is taxed on the sale of new car as well as on the subsequent sale of the "trade-in". Evidently, the legislatures in some states have been receptive to such arguments. See Northrup, *The Measure of Sales Tax*, 9 VAND. L. REV. 237, 258 (1956); Ratchford, *supra*, at 572. But economically the supposed "double taxation" can be justified on the ground that the retail sales tax is essentially a consumption tax.

²² CAL. REV. & TAX. CODE § 6015 defines a "retailer" to include "(a) Every seller who makes any retail sale or sales of tangible personal property . . ." CAL. REV. & TAX. CODE § 6014 defines a "seller" to include "every person engaged in the business of selling tangible personal property of a kind the gross receipts from the retail sale of which are required to be included in the measure of the sales tax." The word "person" is defined in CAL. REV. & TAX. CODE § 6005 by enumeration of various individuals, entities, organizations, and governmental units.

The legal incidence of the sales tax in California is upon the retailer and not upon the consumer. *E.g.*, *De Aryan v. Akers*, 12 Cal. 2d 781, 87 P.2d 695, *cert. denied*, 308 U.S. 581 (1939); *Western Lithograph Co. v. State Bd. of Equalization*, 11 Cal. 2d 156, 78 P.2d 731 (1938); *Pacific Coast Engineering Co. v. California*, 111 Cal. App. 2d 31, 244 P.2d 21 (1952); *Clary v. Basalt Rock Co.*, 99 Cal. App. 2d 458, 222 P.2d 24 (1950). CAL. REV. & TAX. CODE § 6052, however, expressly authorizes the retailer to "pass on" the tax to the consumers and in most cases, the amount of the sales tax which would be applicable to the particular transaction is recovered by the retailer as part of the contract price at which the goods are sold. The reason for permitting the retailer to separate the amount of reimbursement for the sales tax from the basic price is to avoid a "tax on a tax", *i.e.*, the sales tax is measured by the gross receipts from retail sales and the gross receipts includes only the basic price; otherwise, the retailer would not

"Business" is defined in the statute as "any activity engaged in by any person or caused to be engaged in by him with the object of gain, benefit, or advantage, either direct or indirect."²³ The California courts have applied the definition literally. Thus, a person is in the "business" of making retail sales even though the sales are not made for profit.²⁴ Probably the most significant case in enlarging the tax base in this regard and in furnishing a stepping stone to the *Market Street* decision was *Northwestern Pac. R.R. v. State Bd. of Equalization*.²⁵ In that case the taxpayer, a railroad common carrier, had departmentalized its business into the stores department, which regularly sold railroad materials and supplies, and the transportation department, which concerned itself chiefly with transportation. The transportation department made five sales of used rolling stock during 1935, 1936 and 1937. In an alternative ground of decision, the court held that, even if the taxpayer was engaged in the transportation business only, "the number, scope and character of the transfers of rolling stock would still serve to bring them within the purview of the taxing act."²⁶

Subsequent to the *Northwestern Pac.* case, it has been held that a school district which made an average of two to three sales of used equipment for each quarterly period was a retailer and hence taxable on the gross receipts from its retail sales.²⁷ And a county making some 72 sales of used equipment over the course of seven years was deemed a retailer.²⁸ It can thus be summarized that a person, although not principally engaged in selling activity, will be a retailer if he makes retail sales sufficient in "number, scope and character." The "number, scope and character" principle has

be able to obtain complete reimbursement for the sales tax which he must pay. See CAL. REV. & TAX. CODE § 6054; Ruling 80, 18 CAL. ADMIN. CODE § 2100; *De Aryan v. Akers*, *supra*.

The retail sales tax, although legally imposed on the retailer, is economically a consumer's expenditure tax since the burden of the tax is intended to be and is usually shifted to the consumers. JACOBY, RETAIL SALES TAXATION 92-102 (1938); REPORT OF CAL. SENATE INTERIM COMMITTEE ON STATE AND LOCAL TAXATION, STATE AND LOCAL TAXES IN CALIFORNIA: A COMPARATIVE ANALYSIS 63 (1951) (also discusses factors which affect the shifting of the burden to the consumers); Due, *The Nature and Structure of Sales Taxation*, 9 VAND. L. REV. 123 (1956); Studenski, *Characteristics, Developments and Present Status of Consumption Taxes*, 8 LAW & CONTEMP. PROB. 417, 420-22 (1941). But see Ratchford, *supra* note 21, at 572, wherein it is stated that the general theory of the sales tax in this country is "to levy a tax once and only once on the final retail sale of goods."

²³ CAL. REV. & TAX. CODE § 6013.

²⁴ *Union League Club v. Johnson*, 18 Cal. 2d 275, 115 P.2d 425 (1941). For a discussion of whether sales must be made for profit in order to be taxable under the various state sales tax acts, see Cohen, *The Taxable Transaction in Consumers' Taxes*, 8 LAW & CONTEMP. PROB. 530, 537 (1941).

²⁵ 21 Cal. 2d 524, 133 P.2d 400 (1943).

²⁶ The other ground on which this case was decided is discussed at note 36 *infra*.

²⁷ *Los Angeles City High School Dist. v. State Bd. of Equalization*, 71 Cal. App. 2d 486, 163 P.2d 45 (1945).

²⁸ *People v. Imperial County*, 76 Cal. App. 2d 572, 173 P.2d 352 (1946).

been incorporated into the statute,²⁹ but neither the court enunciating the test nor subsequent cases have elaborated on the meaning to be ascribed to these terms.

While the *Northwestern Pac.* case gave judicial recognition to the broad scope of the sales tax by making even those not principally engaged in retail selling business subject to the tax as retailers, it also impliedly limited the tax base by excluding those making few retail sales. Although conceivably the statute could have been construed as imposing a tax upon persons making a single retail sale,³⁰ the State Board of Equalization has not attempted to give the act such broad application.³¹ Since 1951³² a "retailer" has been further defined as one making more than two retail sales of tangible personal property during any twelve-month period.³³

C. The Taxable Retail Sale

The concepts of a "retail sale" and a "retailer" have heretofore been examined independently. The further problem to be considered is the extent to which a person is a "retailer" with respect to his various selling activities. The problem can be framed in terms of hypotheticals. Let us suppose that *B* is engaged in a retail hardware business in which the usual items are sold. *B* sells a truck which he has been using to make deliveries to customers of the retail business. *B* also sells his automobile which he has been using for pleasure—a use which is wholly dissociated from his retail hardware business. Both the truck and the automobile are sold to persons who intend to use them, rather than to resell them. As discussed previously, these are retail sales; but must *B* include the gross receipts from these sales

²⁹ CAL. REV. & TAX. CODE § 6006.5(a), quoted in text at note 47 *infra*.

³⁰ The term "activity" appearing in the definition of "business" in CAL. REV. & TAX. CODE § 6013 does not necessarily imply a continuity or even several transactions. Furthermore, the word "retailer" is defined in CAL. REV. & TAX. CODE § 6015 as a "seller who makes *any* retail sale or sales . . ." (Emphasis added.)

³¹ See 7 OPS. CAL. ATT'Y GEN. 236, 238 (1946); Letter of Sales Tax Counsel, Oct. 1, 1951, 2 P-H CAL. STATE & LOCAL TAX SERV. ¶ 21,138.30; Letter of Sales Tax Counsel, June 18, 1954, 2 P-H CAL. STATE & LOCAL TAX SERV. ¶ 23,579.

³² CAL. REV. & TAX. CODE § 6019.

³³ While the amendment in 1951 adding the further definition of a "retailer" as one making three or more sales during a 12-month period makes no mention of the magnitude of the sales, the State Board of Equalization does not determine taxability on the number of sales alone; it also considers the substantiality of the sales. Letter of Sales Tax Counsel, Apr. 24, 1951, 2 P-H CAL. STATE & LOCAL TAX SERV. ¶ 21,222.25.

CAL. REV. & TAX. CODE § 6019, whether by oversight or otherwise, does not include all those who would come under the general definition of a retailer under CAL. REV. & TAX. CODE § 6005. Presumably, those excluded from § 6019 would have the test of "number, scope and character" applied to them in determining whether they are "retailers" when not otherwise engaged in a regular retail business. If so, does the "number, scope and character" test require a greater number of and more substantial sales than is required under § 6019, or less in both respects?

in the measure of the sales tax? Was *B* a "retailer" with regard to these sales?

*Bigsby v. Johnson*³⁴ offers the judicial solution with respect to the delivery truck. The *Bigsby* case established the principle that the gross receipts from *all* retail sales of tangible personal property made in connection with a retail operation are includable in the measure of the tax *even though* the property sold is not of the kind normally sold in the taxpayer's retail venture. Thus, the sale of the truck is taxable.

What about his private car? Or, suppose a person is engaged in two separate businesses, one a retail business—for example, a clothing store—and the other a non-retail enterprise—for example, construction work; if he should sell equipment used in the non-retail enterprise, would the sale be taxable because he is a retailer by virtue of his other business? The California Supreme Court expressly left this question open in the *Bigsby* case.³⁵ But subsequently, the court in *Northwestern Pac. R.R. v. State Bd. of Equalization*,³⁶ in its first alternative ground of decision refused to give effect to the mere departmentalization of a business. Where the two businesses are completely separate, however, the State Board of Equalization has followed the practice of exempting the sale of property used in a non-retail operation, unless other retail sales made in the course of the non-

³⁴ 18 Cal. 2d 860, 118 P.2d 289 (1941). In this case, the taxpayer operated a printing establishment. He sold a piece of equipment which had been used in his printing business. He argued that because the sale of used equipment was incidental to his principal business and was made in order to salvage the investment in machinery which he could no longer use, the sale was not taxable. The court, in rejecting this argument, said: "... He sold the personal property in question at retail as a part of his business operations, and the plain language of the act requires the inclusion of the gross receipts therefrom in the measure of the tax. He can claim no exemption merely by virtue of the fact that the sale of used printing equipment was not the kind of retail sale ordinarily made by him. Our statute creates no exemption covering the situation, and however forceful may be plaintiff's contention that this type of sale should be exempted from the operation of the statute, such arguments must be directed to the legislature rather than to the courts." *Id.* at 863, 118 P.2d at 291. The court, however, added: "We are not required, under the facts of this case, to decide the question raised in the briefs as to the taxability under the statute of gross receipts from casual retail sales that have no relation whatever to a retailer's business operations." *Ibid.*

³⁵ *Ibid.*

³⁶ 21 Cal. 2d 524, 133 P.2d 400 (1943). The taxpayer in this case was in the transportation business, but in addition to its transportation operations, it made retail sales from its "Stores Department." The sales in question were sales made by the transportation department of used rolling stock. The taxpayer argued that these sales were not taxable because they were occasional sales made in the operation of transportation business rather than in the operation of the "Stores Department." In the alternative holding that the sales were taxable, the court stated: "... While for reasons considered desirable plaintiff corporation may departmentalize its business, it cannot by such process set up for tax purposes a distinction between the types or kinds of sales made by it where the effect would be to cause some of its sales to escape the tax aimed at all of such sales. Specific sales of a retailer cannot be segregated from the bulk of its sales and treated separately as isolated or occasional sales." *Id.* at 529, 133 P.2d at 403.

retail venture are sufficient in number, scope and character to make the person a "retailer" in his non-retail operation.³⁷ Under this analysis, the single retail sale of the private car by our hardware merchant is not subject to the tax.

Subsequent to the *Northwestern Pac.* decision, a federal court was called upon to decide whether the gross receipts from retail sales made by a trustee in bankruptcy in liquidating the property of the bankrupt had to be included in the measure of California's sales tax. In *State Bd. of Equalization v. Boteler*³⁸ and in *State Bd. of Equalization v. Goggin*,³⁹ it was held that no tax was due. The court seemed to say, in both cases, that the trustee in bankruptcy was not a retailer in making the liquidating sales because he did not make the sales in the course of conducting a business.

II

THE SALE OF AN ENTIRE BUSINESS

A. The Judicial Determination of the Issue

This was the setting in which *Market Street Ry. v. State Bd. of Equalization*⁴⁰ arose. Market Street was primarily engaged in the operation of a street railway, but during the period between 1933 and 1948, it had made some 900 separate retail sales. These, with one exception, were sales of obsolete equipment, accommodation sales to its employees, and sales from its quarry; the exception was the sale in 1944 of all its operating property to the City and County of San Francisco. After the sale to the city, Market Street ceased its business of operating a street railway system and made additional sales in liquidation of the remaining property. The total gross receipts from the sale of tangible personal property other than from the sale to the city amounted to about one hundred thousand dollars. In contrast, the value of the tangible personal property included in the sale to the city was over two and one-half million dollars. In 1949, the State Board of Equalization, upon discovery of these sales, assessed a deficiency against Market Street.

³⁷ See 7 OPS. CAL. ATT'Y GEN. 236 (1946) (whether the different types of business conducted by one retailer are separate and distinct is to be determined by economic interrelationship rather than physical proximity).

The language of CAL. REV. & TAX. CODE § 6006.5(a), which defines the "occasional sale" made expressly exempt in 1947 (Cal. Stat. 1947, c. 855; CAL. REV. & TAX. CODE § 6367), does not aid in solving this problem whether sales made in a nonretail business by a retailer who also conducts a retail business would be taxable since the issue is still whether the businesses are related.

³⁸ 131 F.2d 386 (9th Cir. 1942).

³⁹ 191 F.2d 726 (9th Cir. 1951), *cert. denied*, 342 U.S. 909 (1952).

⁴⁰ 137 Cal. App. 2d 87, 290 P.2d 20 (1955), noted in 4 U.C.L.A.L. REV. 154 (1956).

Because of the hundreds of retail sales made by Market Street before the sale of operating property to the city, Market Street was undoubtedly a "retailer" under the test of "number, scope and character" set forth in the *Northwestern Pac.* case. Equally clear is the fact that the sale to the city was a "retail sale" since the city did not make the purchase for the purpose of resale. It was argued, however, that the Sales and Use Tax Law never contemplated that the gross receipts from the sale of a business be included in the measure of the tax since the tax was on the business of making retail sales rather than a tax on going out of business. The court, however, finding no exemption in the statute for the sale of an entire business as such, held that Market Street was a retailer and the sale to the city a retail sale, thus subject to the tax.⁴¹ The federal decisions were rejected.⁴² While the court did not articulate whether it was following the *Bigsby* approach—that is, that once a person is deemed a retailer, all retail sales made in connection with his business operation are subject to the tax—or applying the "number, scope and character" test in holding the sale to the city taxable, its syllogistic reasoning leads to the conclusion that it was further extending the principle evolved in the *Bigsby* case.

The *Market Street* case marks the evolution of this principle from its modest origin in the *Bigsby* case. In the *Bigsby* case,⁴³ the taxpayer was avowedly a retailer principally engaged in making retail sales and the property, the sale of which was in question, was used in the course of the retail business. In the *Northwestern Pac.* case,⁴⁴ the taxpayer was engaged in a regular retail business but the sales in question were of properties which were neither held nor used directly in the regular retail operations. In the *Market Street* case, however, Market Street was not engaged in a regular retail business; Market Street was a retailer at the time of the sale to the

⁴¹ *Ibid.* It is interesting to note an opinion by the Sales Tax Counsel of the State Board of Equalization, April 24, 1951, 2 P-H CAL. STATE & LOCAL TAX SERV. § 21,222.25: "The number of sales is only one element to be considered. In this case we have in the twelve-month period commencing January 24, 1947, five sales, three are \$15 in amount, and one is \$25 in amount. These are so small in amount that we believe it would be unreasonable and not a proper interpretation of the *Northwestern Pacific Railroad* case to say that merely because these four insignificant sales were made the tax applies to the \$50,000 sale made within the same twelve-month period"

In the case considered by the Sales Tax Counsel, the total gross receipts prior to the large sale was .14% of the receipt from the large sale. In the *Market Street* case, the total gross receipts from sales other than the sale to the city was approximately 4% of the receipts from the sale of tangible personal property to the city. But in the *Market Street* case, the period covered was from 1933 to 1948, whereas, in the case considered by the Sales Tax Counsel, there was but one year. It is difficult to predict where the State Board of Equalization will draw the line since it has not set forth any definitive standard while refusing to construe CAL. REV. & TAX CODE § 6019 strictly.

⁴² 137 Cal. App. 2d at 99, 290 P.2d at 27.

⁴³ See note 34 *supra*.

⁴⁴ See note 36 *supra*.

city only because of the application of the "number, scope and character" test to the prior retail sales of obsolete equipment.

The choice of theory, that is to say, whether the *Bigsby* approach or the "number, scope, and character" test is to be used, may be of some consequence. For example, recall our hypothetical operator of a retail hardware business. He uses such necessary equipment as cash registers, desks, typewriters, and trucks, in operating his retail business. He has never sold new or used cash registers, nor any of the other enumerated items of equipment. Let us suppose that he sells his entire business, including the inventory and the equipment used in the business. Under the *Bigsby* approach, it might be sufficient to argue that the retailer is taxable on the transfer of all the tangible personal property because he "sold the personal property in question at retail as a part of his business operations."⁴⁵ Under the ill-defined "number, scope and character" test, however, different considerations would apply. It becomes necessary to ask whether the transfer of used cash registers, trucks, and so forth, included in the sale of the entire business is different in scope and character from the usual retail sales. If so, there is but one sale of such property and the merchant will not qualify as a retailer of such equipment.

Thus, the two theories can produce different results. And since 1947 it has become especially important to determine the meaning of "number, scope, and character." In that year the statute was amended and an exemption was enacted for "occasional sales"⁴⁶ defined to include "a sale of property not held or used by a seller in the course of an activity for which he is required to hold a seller's permit, provided such sale is not one of a series of sales sufficient in number, scope and character to constitute an activity requiring the holding of a seller's permit".⁴⁷ Probably, the legislative intent was to codify the rule in the *Bigsby* case and the "number, scope and character" test in the *Northwestern Pac.* case, but in doing so, the Legislature has set the outer limits on the *Bigsby* rule. Thus, under the *Bigsby* rule as codified in the statute, only those items of property which are held or used in the course of an activity for which a seller's permit is required are subject to the sales tax. In short, in the type of factual situation presented by the *Market Street* case—which involved a pre-1947 sale—the only possible applicable theory under the 1947 amendment is the "number, scope and character" test; this is because it would be extremely difficult to conclude that the equipment used in the transportation business was being held or used in the retail activity of selling used or obsolete equipment.

⁴⁵ Our example is an easier case than the *Market Street* case since the property in question is held or used in the course of an activity for which a seller's permit is required; the only question is whether a liquidation sale should be exempt merely because it is a liquidation sale.

⁴⁶ CAL. REV. & TAX. CODE §§ 6006.5, 6367.

⁴⁷ CAL. REV. & TAX. CODE § 6006.5(a).

It remained for the *Sutter Packing Co. v. State Bd. of Equalization*,⁴⁸ decided about four months after the *Market Street* case, to determine whether the post-1947 sale of the bulk of the business property was subject to the tax under the "number, scope and character" test when prior sales of obsolete equipment had been made. Sutter Packing was engaged in the business of processing, packing, selling and distributing canned fruits and vegetables for resale. During the period beginning September 1, 1945, and ending March 31, 1949, however, Sutter Packing made several retail sales of used equipment and various supplies on which sales tax was paid; and on one occasion Sutter Packing had sold all its equipment for the sum of \$264,819.72, paying sales tax thereon as mentioned. In fact, Sutter had a seller's permit for the purpose of making sales of obsolete equipment. In the last quarter of 1948, Sutter Packing made ten retail sales. In the first quarter of 1949, one retail sale was made; it was in this quarter that Sutter decided to terminate its business. On March 26, 1949, it transferred all its inventory items to an affiliated company. On April 15, 1949, it obtained a cancellation of its seller's permit effective March 31, 1949. And on May 4, 1949, the sale of equipment, furniture, and fixtures was made to a non-affiliated company for a price of \$700,000. In opposing the inclusion of gross receipts from the sale of tangible personal property made on May 4, 1949, in the measure of the sales tax, Sutter Packing argued that it was no longer a retailer when the last sale was made and also that liquidating sales were not taxable. The court held that Sutter Packing was still a retailer at the time the last sale was made since negotiations for that sale had commenced immediately after its decision to discontinue business on or about March 15, 1949, and upheld the trial court's conclusion that the last sale was one of the series of sales made by Sutter Packing. Facing squarely the issue whether the sale in liquidation was "one of a series of sales sufficient in number, scope and character to constitute an activity requiring a seller's permit", the court stated:⁴⁹

There appears to be nothing, however, inherently different in the nature of the items sold in the final sale than in the earlier sales of used equipment, although it is true that it was a much larger sale of a greater variety of items. Appellant says that this was truly an occasional sale since the sale of the entire assets could happen only once. However, the same may be said for each smaller item sold. Similar sales might be made, and appellant herein had, in fact, made a similar sale of all of its equipment and machinery in the plant in 1945.

The fact alone that the last sale was made in liquidation of a business is apparently not such a distinction in the nature of the sale as to warrant an exemption if it would otherwise have been considered part of a series of

⁴⁸ 139 Cal. App. 2d 889, 294 P.2d 1083 (1956), *hearing denied*, May 15, 1956.

⁴⁹ *Id.* at 895-96, 294 P.2d at 1087.

sales sufficient in number, scope and character to constitute an activity requiring a seller's permit and subjecting it to the tax.

Thus, the *Sutter Packing* case demonstrates that the 1947 amendment adding the occasional sale exemption to the Sales and Use Tax Law does not exempt sales from taxation merely because they are made in the process of liquidating the business. Moreover, whatever the meaning which might be attributed to each word in the "number, scope and character" test, the totality of its import here is that a sale of an entire business can be considered as one of the same series as the prior sales of obsolete equipment.

B. The Related Problems

While the basic sales tax consequence of a sale of the entire business has been discussed, additional related problems remain. In this section, some general problem areas will be developed: What is the scope of the "occasional sale" exemption of section 6006.5(a)? Are wholesalers subjected to inequitable treatment? Under the "number, scope and character" test, at what point do the sales become subject to taxation?

To illustrate the first, suppose that B Corporation, as was Northwestern Pacific in that case,⁵⁰ is engaged primarily in operating a transportation system, but as a secondary business conducts a retail operation in which materials and supplies are sold. B Corporation has never sold used equipment or rolling stock discarded from its transportation business. B Corporation sells the entire business to C Corporation in a retail sale. The taxability of the transfer of items of property not directly related to the retail selling activity will depend upon the interpretation of the "occasional sale" exemption as defined in section 6006.5(a).⁵¹

The first question is whether the tangible personal property used in the transportation business was "held or used" in the course of the retail selling activity, that is, "in the course of an activity for which a seller's permit

⁵⁰ For the facts in this case, see text at note 25 *supra*.

⁵¹ It would seem that items of tangible personal property held or used in the retail selling activity are subject to the tax unless the property is bought by the purchaser for resale. This would mean that component items of property included in one sale must be segregated to determine the taxable items, as was done in *Market Street Ry. v. State Board of Equalization*, 137 Cal. App. 2d 87, 290 P.2d 20 (1955). But cf. *Geneva Steel Co. v. State Tax Comm'n*, 116 Utah 170, 209 P.2d 208 (1949), where the court considered the sale of an entire business to be sui generis since it involved the transfer of various types of property, real as well as personal, tangible as well as intangible.

The sale of an entire business under one contract appears to be treated as one sale. Cf. Letter of Sales Tax Counsel, Feb. 19, 1951, 2 P-H CAL. STATE & LOCAL TAX SERV. ¶ 21,222.85. And it is the number of transactions, rather than the number of items of property transferred, which is relevant to the underlying consideration for exempting those who make only a few retail sales since the reason for excluding them from the tax is administrative convenience. See Frampton and Smith, *Commodities and Transactions Exempt from Consumption Taxes*, 8 LAW & CONTEMP. PROB. 579, 590 (1941).

is required";⁵² if it was so held or used, an exemption will be denied; if not, the sale comes within the exemption. The negative restriction that property not be "*held*" in the course of an activity for which a seller's permit is required was probably intended to exclude from the exemption inventory items which are to be used or sold in the retail selling operation. It would seem unreasonable to consider the property used or held in the operation of a transportation system as "*held*" for the retail activity. Nor can it be reasonably said that such property as rolling stock employed in the operation of the transportation activity was "*used*" in the retail business. The restriction that property not be "*used*" in the course of an activity for which a seller's permit is required was probably designed to exclude from the exemption property sold which was used directly in the retail activity—the precise situation in the *Bigsby* case. In other words, by the use of the phrase "in the activity for which he is required to hold a seller's permit" in section 6006.5(a), the legislature, it would seem, intended to exempt a single sale of property which was not directly related to the retail selling activity. In the above hypothetical, B Corporation—prior to the sale in question—was engaged in a number of different activities, only one of which was the retail selling activity. In short, it appears that the first alternative ground of decision in the *Northwestern Pac.*⁵³ case has been rejected in section 6006.5(a) and that the transfer of the used property, other than that used or held in the course of the retail operation, in the sale of the entire business to C Corporation would not be denied the exemption based on the first restriction in section 6006.5(a).

Even if the sale of the entire business clears this first hurdle, the question whether the sale was "one of series of sales sufficient in number, scope and character to constitute an activity requiring the holding of a seller's permit" still remains. If it were necessary to determine whether the sale of used equipment and rolling stock was of the same scope and character as the sale of materials and supplies in the retail department, the solution would not be easy,⁵⁴ but it is submitted that the "number, scope and character" test should be applied only to sales of tangible personal property unrelated to normal retail selling activity. In other words, in the instant hypothetical,

⁵² CAL. REV. & TAX. CODE § 6006.5(a) quoted in text at note 47 *supra*.

⁵³ See text at notes 36 and 37 *supra*.

⁵⁴ "Number" is easily understood. The term "scope" presumably refers to the substantiality or magnitude of the sales; in other words, five or six sales of used golf irons by an individual would not suffice to make the sales taxable. See Letter of Sales Tax Counsel, Apr. 24, 1951, 2 P-H CAL. STATE & LOCAL TAX SERV. ¶ 21,222.25. The word "character" as used in the test is more difficult to understand. It can mean the nature of the sale, *i.e.*, whether it is a liquidating sale of capital asset or a normal sale of inventory items held for sale; it can refer to a distinction between a "sale for resale" or a "retail" sale; or it can refer to the type of property, *i.e.*, automobiles or pots and pans. It may be that the term "character" encompasses all of these distinctions.

the sales made in the usual retail selling activity should not be considered together with the transfer of assets unrelated to that selling activity in applying the "number, scope and character" test to a sale of the entire business. The denial of the "occasional sale" exemption in the first instance depends upon whether the property sold is directly related to the retail selling activity. Only if the property is not so related should the proviso of "number, scope and character" be applied in determining the taxability of the sale in question by a consideration of the sales, if any, of other property unrelated to the retail selling activity. If this construction of the statute is correct, the transfer of tangible personal property used in the transportation business in the sale of the entire business by B Corporation is the only relevant sale and will not be sufficient in "number, scope and character" to disqualify the transfer of such property from the exemption accorded to an "occasional sale".

The second problem area may be illustrated by the following factual situations. First, suppose that D Corporation is engaged in the wholesale business of selling tires for resale. Prior to the sale of its entire business to E Corporation it has made no retail sales. Although D Corporation was not previously taxed because its sales were for resale, the State Board of Equalization will tax the transfer of tangible personal property included in the sale of the entire business, at least to the extent of such property held or used in the course of the wholesale activity. By contrast, consider the case of F Corporation which is engaged in selling food products to consumers and makes no sales of any other type of property. Even if F Corporation should sell its entire business to G Corporation, F Corporation will not be taxed.

According to the State Board of Equalization, D Corporation is a "seller"⁵⁵ since it was engaged in the business of selling the kind of property which is not exempt under the statute and D Corporation was relieved of paying taxes on the sales of tires only because of the nature of the sales, that is, sales for resale; D Corporation, when selling its entire business, was making a retail sale with respect to its equipment and other tangible personal property; a retail sale of such property is not exempt under section 6006.5(a) because such items of property were held or used in an activity for which a seller's permit was required; section 6019, which further defines a "retailer" as a person making three or more retail sales during a twelve-month period, is not a restriction on the general definition of a "retailer" under section 6015; thus, the sale of an entire business is sub-

⁵⁵ Note 56 *infra*. CAL. REV. & TAX. CODE § 6014 defines a "seller" to include "every person engaged in the business of selling tangible personal property of a kind the gross receipts from the retail sale of which are required to be included in the measure of the sales tax." Retail sales of tires are not exempt from the sales tax.

ject to the tax.⁵⁶ On the other hand, the Board reasons that because F Corporation was engaged in selling food products, a type of property the sale of which is exempt, F Corporation was not a "seller"; therefore, the "occasional sale" exemption will apply.⁵⁷

The above distinction seems unjustified. While it is true that D Corporation was a "seller" within the meaning of the statute and that the items of property transferred in the sale of the entire business were used in the course of an activity for which a seller's permit was required, the only retail sale made by D Corporation was the sale of the entire business—just one retail sale. The Board has not attempted to tax a person making a single retail sale under other circumstances.⁵⁸ It is difficult to discover the policy rationale of this discrimination against wholesalers.

Although the statute requires wholesalers of non-exempt property to obtain a seller's permit,⁵⁹ to furnish resale certificates to rebut the presumption of making retail sales,⁶⁰ and to file returns,⁶¹ these provisions do not compel the conclusion that a single retail sale by a wholesaler of property held or used in the selling activity is taxable. In the final analysis, the answer depends upon reconciling the definition of a "retailer" as a person making three or more retail sales during any twelve-month period with the administrative practice of exempting a single retail sale by a person not engaged in the commercial venture of making sales. The State Board of Equalization has construed section 6019 as enlarging the scope of the tax base rather than restricting it; in other words, according to administrative practice, if a person makes three or more retail sales during a twelve-month period, he is apt to be a "retailer" subject to tax on the retail sales, but a person who makes less than three retail sales is not necessarily excluded from the coverage of the sales tax.⁶² Whatever may be the merit of this construction as applied to a retail sale of the kind of property normally

⁵⁶ Letters of Sales Tax Counsel, Jan. 31, 1951 and Dec. 4, 1953, 2 P-H CAL. STATE & LOCAL TAX SERV. ¶¶ 21,139.10, 21,138.25. The State Board of Equalization can further point to CAL. REV. & TAX. CODE § 6015 which defines a "retailer" as a "seller who makes any retail sale or sales . . ." It may be argued that even a person who does not regularly engage in the business of selling tangible personal property is engaged in the business of selling tangible personal property with respect to one sale, but evidently the State Board of Equalization does not construe the term "business" as defined in CAL. REV. & TAX. CODE § 6013 literally. The difficulty arises from the nebulous character of the term "business."

⁵⁷ Letter of Sales Tax Counsel, Dec. 4, 1953, 2 P-H CAL. STATE & LOCAL TAX SERV. ¶ 21,138.25. The retail sale of "food products" would be exempt under CAL. REV. & TAX. CODE § 6359. Therefore, F Corporation would not be a "seller" under CAL. REV. & TAX. CODE § 6014.

⁵⁸ Note 31 *supra*.

⁵⁹ CAL. REV. & TAX. CODE § 6066; Rule No. 79, 18 CAL. ADMIN. CODE § 2099.

⁶⁰ CAL. REV. & TAX. CODE §§ 6091-92.

⁶¹ CAL. REV. & TAX. CODE § 6452.

⁶² Letter of Sales Tax Counsel, Dec. 4, 1953, 2 P-H CAL. STATE & LOCAL TAX SERV. ¶ 21,138.25.

sold at wholesale by D Corporation, the sale of other tangible personal property should be differentiated. A retail sale of the kind of property normally sold at wholesale by D Corporation might be analogized to a regular retailer making his first retail sale.⁶³ In both cases, the sales are made in the course of the usual business of selling the kind of property in question. On the other hand, a retail sale of used property of a kind not normally sold by a wholesaler is no different from a retail sale by a person not engaged in the business of selling. The sales tax is a tax on a retailer for the privilege of making retail sales.⁶⁴ And if the agency exempts a single retail sale by a person not engaged in the business of making sales, the wholesaler, who is likewise not engaged in the business of making retail sales of property in question, should be exempt. Furthermore, there appears to be no rational policy served by exempting F Corporation while taxing D Corporation. The nature and extent of exercise of the privilege of making a retail sale of the entire business is the same in either case. The sale of food products at retail by F Corporation is exempt because of the legislative desire to ameliorate the regressive features of the sales tax. The sale of tires for resale by D Corporation is excluded from the tax because the sales tax is basically a consumer's expenditure tax. Neither of these reasons for the non-taxability of the usual sales of the two corporations bear upon the taxability of the later sale of the entire business.

Once it is determined that a wholesaler is subject to taxation on the tangible personal property—even of a kind other than that normally sold in connection with his wholesale business—included in a sale of his entire business, the next logical step is the taxation of the sale of an entire business by a person who has become a wholesaler by virtue of the “number, scope and character” of his sales for resale. While the State Board of Equalization has been willing to construe the statute strictly in the case of the wholesaler discussed above, it has refused to take this next step.⁶⁵ Thus, suppose that H Corporation is engaged in the construction business in which trucks are used. If it trades these trucks in for new trucks from time

⁶³ An argument can be made that the negative implication of CAL. REV. & TAX. CODE § 6019 is that a person who makes less than three retail sales during a twelve-month period is exempt under any circumstance. To so construe that section would mean that a person who is just starting out in business, or who is engaged in selling a type of property which cannot be sold readily, or who otherwise does not make three or more sales due to business conditions, would be exempt. But it would seem that a person who professes to be in the regular business of making retail sales of tangible personal property should be required to pay the sales tax on even a few retail sales.

The reason for the enactment of § 6019 is not clear. Conceivably, it was enacted to clarify the tax consequences of a person who acts as a trustee in bankruptcy and who makes retail sales of tangible personal property in the various bankrupts' estates.

⁶⁴ CAL. REV. & TAX. CODE § 6051.

⁶⁵ Sales Tax Gen. Bull. 57-12, May 6, 1957, 2 P-H CAL. STATE & LOCAL TAX SERV. ¶23,790-P.

to time, the sales—even though for resale—might be sufficient in number, scope and character to make H Corporation a “seller” of these trucks. If H Corporation is a “seller”, a single retail sale of the entire business should subject all the tangible personal property to the sales tax regardless of whether it was held or used in the course of the truck selling activity under the reasoning of the *Sutter Packing* case.

The third problem area may be briefly mentioned. Suppose that L Corporation is engaged in the business of selling food products. It has never made any sale of property, the gross receipts from the retail sale of which are required to be included in the measure of the sales tax. L Corporation then sells most of its assets to M Corporation for a purpose other than resale, but a few items of furniture and equipment are not included in the sale. Subsequently, L Corporation sells the remaining items of tangible personal property to different purchasers in ten separate retail sales. Although L Corporation has become a “retailer” under the “number, scope and character” test, is L Corporation taxable for the first sale? The first sale was the beginning of the series of sales sufficient in number, scope and character to make L Corporation a retailer, but at the time of the first sale, L Corporation was not a retailer. And because the sales tax is imposed upon a retailer, logically it would seem that L Corporation should not be taxed upon the first few sales. In *Northwestern Pac. R.R. v. State Bd. of Equalization*,⁶⁶ however, the court assumed without discussion that a person who becomes a retailer under the number, scope and character test is taxable upon the earlier sales in the series. And the State Board of Equalization would hold him taxable from the first sale,⁶⁷ a position which might be rationalized upon the basis of the resulting equity among retailers.⁶⁸

C. Precautionary Measures in Planning and Negotiating the Sale of an Entire Business

Until such time as the law is amended to provide some definitive test, a person not otherwise engaged in the business of making retail sales who contemplates a sale of an entire business would be wise to refrain from making even a few sales of his obsolete equipment. Or if he has been making retail sales of obsolete equipment, it might be well to discontinue such

⁶⁶ 21 Cal. 2d 524, 133 P.2d 400 (1943). For a discussion of this case, see note 27 *supra*.

⁶⁷ Letter of Sales Tax Counsel, Aug. 11, 1952, 2 P-H CAL. STATE & LOCAL TAX SERV. ¶ 21,182.10. The State Board of Equalization states, however, that earlier sales by a person not engaged in the business of making retail sales are not made by a retailer for purposes of the purchaser's liability under CAL. REV. & TAX. CODE §§ 6811, 6812. *Ibid*.

⁶⁸ One would hardly dispute the taxability of the first sale made by a person embarking on a regular retail venture. Similarly, those who become retailers by virtue of the number, scope and character test should be subject to the tax upon the first sale if later sales are contemplated. Unless the agency practice is followed, if a series of sales are made, difficult problems of proof will arise as to whether earlier sales were made in contemplation of additional sales.

sales for a continuous period of at least twelve months prior to selling the entire business; this will enable him to make the argument that he quit his retail business prior to making the sale of the entire business. Whether this latter strategem will prevail depends, in the final analysis, upon whether section 6019—defining a retailer as one making more than two retail sales during any twelve-month period—is construed as impliedly excluding those making two or less retail sales during that period from the definition of a retailer.⁶⁹ Section 6019 certainly is subject to this construction. Furthermore, one should avoid liquidating his property in more than two transactions, for otherwise he leaves himself vulnerable to the contention that he was a retailer making retail sales and is faced with the possibility of being taxed from the first sale.

There is a gambit open to the corporate seller which is not available to the sole proprietor. When a sale of entire assets is contemplated and the corporation is a regular retailer or has been making sales of obsolete equipment, it may be advisable for the shareholders to sell their shares to the purchaser. By the sale of intangible personal property, the impact of the sales tax can be avoided. In the alternative, the corporation might distribute the property to shareholders who in turn can transfer the property to the purchaser. Since the shareholders are not apt to be "retailers", the tax may not apply. If, however, in trying these gambits, the corporation should engage in preliminary negotiations for the sale of assets of the corporation, the State Board of Equalization might borrow the doctrine of the *Court Holding* case⁷⁰ and assert the tax on the corporation itself.

If the seller has any doubt as to the tax consequences of the sale of his entire business and desires to shift the burden of the tax which might be applicable, he should include a provision in the contract of sale obligating the purchaser to reimburse him for the amount of any sales tax on the sale in question. Unless such a provision is inserted, the seller will have no recourse against the buyer if a tax is later imposed.⁷¹

Heretofore, the sales tax consequences of the sale of an entire business

⁶⁹ Cf. *People v. Gabriel*, 57 Cal. App. 2d 788, 135 P.2d 378 (1943) (successor's liability held not to apply to purchaser where the seller discontinued his business prior to the sale).

⁷⁰ *Commissioner v. Court Holding Co.*, 324 U.S. 331 (1945) (corporation negotiated for the sale of its property and reached an oral agreement, but upon realization of the income tax consequences, property was distributed to shareholders and then sold by them; held, the gain from the sale of property is attributable to the corporation). For a more complete discussion of the Court Holding doctrine, see SURREY & WARREN, *FEDERAL INCOME TAXATION* 1147-59 (1955). See also Letter of Sales Tax Counsel, Dec. 28, 1953, 2 P-H CAL. STATE & LOCAL TAX SERV. ¶ 21,222.35 (Sales Tax Counsel states that, where corporation did not negotiate for sale of property, this distribution in kind to sole shareholder and the subsequent sale thereof by the shareholder constitutes an exempt distribution and an exempt occasional sale.).

⁷¹ E.g., *Pacific Coast Engineering Co. v. California*, 111 Cal. App. 2d 31, 244 P.2d 21 (1952); *Clary v. Basalt Rock Co.*, 99 Cal. App. 2d 458, 222 P.2d 24 (1950).

has been considered from the viewpoint of the seller. The purchaser, too, cannot remain oblivious to these problems. Section 6811 provides that "if any retailer liable for any amount under this part sells out his business or stock of goods or quits the business, his successors or assigns shall withhold sufficient of the purchase price to cover such amount until the former owner produces a receipt from the board showing that it has been paid or a certificate stating that no amount is due."⁷² The innocent purchaser of the assets of a railroad company, for example, might find himself faced with not only the tax on sales of equipment made by the seller during the preceding period, but also with the tax on the transfer of all the tangible personal property included in the sale of the entire business to him. Regardless of the type of business in which the seller is engaged, the purchaser should protect himself by obtaining a certificate from the State Board of Equalization under the provisions of section 6812.⁷³

Aside from the successor's liability, the purchaser who buys an entire business out of state and brings to California tangible personal property included in such sale may find that he is subject to the use tax in the event that the out of state seller made previous retail sales—for example, a few sales of obsolete equipment. The purchaser should be extremely wary as to whether his seller is a retailer within the meaning of California's Sales and Use Tax Law.⁷⁴

III

FORMATION, REORGANIZATION, AND DISSOLUTION OF BUSINESS ENTERPRISES

If uncertainty shrouds the sales tax consequences of the sale of an entire business, utter confusion is encountered with respect to the taxability of transfers incident to the formation and reorganization of business enterprises. As suggested at the outset, the *Market Street* and *Sutter Packing* cases have created a possibility that the sales tax might be applicable to the formation, reorganization, and dissolution of business enterprises.

Had these cases reached a contrary result on the taxability of liquidating sales, the State Board of Equalization would certainly have been foreclosed from expanding the tax base to include transfer of tangible personal property attendant to the organization or reorganization of business enterprises or to distributions in kind. In order to have held that liquidating sales were not subject to the tax, the court would have reasoned that liquidating

⁷² CAL. REV. & TAX. CODE § 6811.

⁷³ CAL. REV. & TAX. CODE § 6812. For a discussion of problems arising from this successor's liability in relation to bulk sales, see Ring, *Bulk Sales Problems in California*, 42 CALIF. L. REV. 579 (1954).

⁷⁴ The use tax is imposed on "the storage, use, or other consumption in this State of tangible personal property purchased from any retailer . . ." CAL. REV. & TAX. CODE § 6201.

sales were not the type of sales "intended" by the Legislature to be covered by the Sales and Use Tax Law, even though there was no express exemption therefor, and that "business" meant the commercial venture of selling in the course of conducting the business. It would then be an easy step to conclude that transfers upon the formation and reorganization of business enterprises and upon distributions in kind, even if considered to be sales, were not within the intended purview of the tax. Because the *Market Street* and *Sutter Packing* cases have refused to find unwritten exemptions and have followed the charted course of literal construction, the taxability of transfers of tangible personal property upon the formation or reorganization of a partnership or corporation or distributions in kind is no longer merely an academic question.

To provide a setting for the discussion, a few problems will be posed. First, suppose that *B* who is engaged in a retail business as a sole proprietor decides to form a partnership with *C*. *B* contributes the assets of his retail business and *C* contributes cash to the partnership. Must *B* include any or all of the "gross receipts" from the transfer of the tangible personal property to the partnership in the measure of the sales tax? Second, suppose that *D* Corporation and *E* Corporation, both in the retail business, merge or consolidate. What is the sales tax significance of the transfer to the surviving or the consolidated corporation? Third, suppose that *D* Corporation decides, by dissolving its wholly-owned subsidiary engaged in the retail business, to acquire its assets. Is the subsidiary subject to the sales tax? In all these hypotheticals the issues are deceptively simple, but they are without immediate answers. The first consideration is whether there is a "sale" within the meaning of the Sales and Use Tax Law. The second is whether the provisions of section 6006.5(b)—further defining an "occasional sale"—bring these transactions within the occasional sale exemption. The solution to the first issue depends upon whether the commonly accepted characterizations of the transactions in question are to be disturbed by the broad statutory definition of a "sale". The answer to the second is hopelessly confused by poor draftsmanship. Heretofore, there have been no appellate decisions to lend direction in this area where the statutory language leads to uncertainty.^{74a} The State Board of Equalization appears to be treading carefully on an ad hoc basis. In the ensuing discussion, the considerations relevant to the resolution of these problems will be explored.

A. Is There a "Sale"?

The initial issue underlying the taxation of transactions relative to the formation and reorganization of business enterprises and to distributions

^{74a} Exemption was claimed under the section in *Pacific Pipeline Constr. Co. v. State Bd. of Equalization*, 309 P.2d 866 (Cal. App. 1957), and rejected on the ground that the record contained "no finding or evidence" to support the claim. *Id.* at 870. The California Supreme Court granted a hearing June 12, 1957.

in kind is whether there is a "sale", for unless there is a "sale", the Sales and Use Tax Law is not applicable. A "sale" is defined to include:⁷⁵

any transfer of title or possession, exchange, barter, lease, or rental, conditional or otherwise, in any manner or by any means whatsoever, of tangible personal property for a consideration. "Transfer of possession", "lease", or "rental" includes only transactions found by the board to be in lieu of a transfer of title, exchange, or barter.

It is apparent that "sale" has been defined broadly; all that is required is a transfer of tangible personal property for a consideration.

1. Formation of Business Enterprises

The conclusion that there is no "sale" when property is transferred to a newly organized corporation in exchange for its shares may be reached on the basis that the transfer incident to incorporation is *sui generis*, that it is merely a capital contribution to breathe life into the corporation, and that the ultimate ownership and control of the property remain with the transferors. A contrary argument may be based upon the concept that the corporation has an existence separate from its shareholders.⁷⁶ Whether made pursuant to a subscription or a purchase agreement for shares, the voluntary transfer is made in exchange for an intangible "bundle of rights" different from direct ownership; the shareholder's rights *vis-a-vis* the corporation and its assets are determined by the corporate statutes, articles of incorporation, and by-laws; in short, because the transferor has received a species of property in exchange for his original property, he has transferred property for a consideration.⁷⁷

⁷⁵ CAL. REV. & TAX. CODE § 6006(a).

⁷⁶ *E.g.*, *Northwestern Pac. R.R. v. State Bd. of Equalization*, 21 Cal. 2d 524, 133 P.2d 400 (1943) (transfer by wholly-owned subsidiary to parent deemed a "sale" under the sales tax act); *Rexall Drug Co. v. Peterson*, 113 Cal. App. 2d 528, 248 P.2d 433 (1952); see also *Miller v. McColgan*, 17 Cal. 2d 432, 110 P.2d 419 (1941) (distinguishing between the ownership of corporate property and ownership of corporate shares for the purpose of determining the source of income to shareholder); *Henley v. Franchise Tax Bd.*, 122 Cal. App. 2d 1, 264 P.2d 179 (1953) (*contra Miller case*).

⁷⁷ Support for this conclusion might be found in the income tax cases. Prior to the enactment of the nonrecognition of gain or loss provisions upon formation of a corporation, the courts held that there was a realization of gain or loss upon transfer of property to a corporation in return for its shares. *E.g.*, *Insurance and Title Guarantee Co. v. Commissioner*, 36 F.2d 842 (2d Cir. 1929), *cert. denied*, 281 U.S. 748 (1930); *S.R. Roseberg*, 13 B.T.A. 503 (1928), *modified by stipulation*, 44 F.2d 1019 (9th Cir. 1930); *Jefferson Livingston*, 18 B.T.A. 1184 (1930); *Leslie H. Fawkes*, 14 B.T.A. 977 (1929); *Warren E. Brown*, 4 B.T.A. 56 (1926); *West Point Investment Co.*, 1 B.T.A. 436 (1925). *Contra*, *Schoenheit v. Lucas*, 44 F.2d 476 (4th Cir. 1930) (no gain when sole shareholder exchanged property for shares of his corporation). For holdings that there is no income or loss because there is no market value for the shares, see *Mount v. Commissioner*, 48 F.2d 550 (2d Cir. 1931); *Tsivoglou v. United States*, 31 F.2d 706 (1st Cir. 1929) (taxpayer's claim of loss upon incorporation denied); *Heafey v. Allen*, 34 F.2d 941 (D. Nev. 1929) (court refused to value the shares by the value of the property contrib-

With respect to a partnership difficulty arises from the amorphous legal nature of the partnership itself, that is, whether the partnership is to be regarded as a legal entity, merely as an aggregate of individuals, or as a hybrid. Under the Uniform Partnership Act,⁷⁸ there appear to be some characteristics which support the entity theory while at the same time others immediately cast doubt on such a conclusion.⁷⁹ In several California cases, the entity theory has been expressly repudiated without reliance on any statutory provision.⁸⁰ The proper approach would appear to be to avoid errors stemming from a categorical label by resolving the issue by the demands of the dispute. The narrow issue is whether the partnership is an entity for the purpose of the Sales and Use Tax Law. Section 6006.5(b) which defines an occasional sale seems to make reference to a partnership as "other entity"⁸¹ and thus may support the conclusion that a partnership is to be treated as a separate entity. If so, the sales tax consequence should be similar to that of a transfer of assets in the formation of a corporation. Aside from this possible characterization, it can be persuasively argued that a person who transfers tangible personal property to a partnership in

uted); *O'Meara v. Commissioner*, 34 F.2d 390 (10th Cir. 1929); *Andrew B. C. Dohrmann*, 19 B.T.A. 507 (1930). For additional discussion and cases, see *MAGILL, TAXABLE INCOME* 127-33 (rev. ed. 1945).

In *Van Heusen v. Commissioner of Corp. and Taxation*, 257 Mass. 488, 154 N.E. 257 (1926), it was held that there was a sale upon transfer of property to a newly organized corporation in return for its shares but that there was no gain by mere change in type of control over the property. See also *Miller v. Tax Comm'n*, 195 Wis. 219, 217 N.W. 568 (1928).

Inasmuch as the Court has required an exchange of "essentially different thing", *Eisner v. Macomber*, 252 U.S. 189 (1920); *United States v. Phellis*, 257 U.S. 156 (1921); *Rockefeller v. United States*, 257 U.S. 176 (1921); *Cullinan v. Walker*, 262 U.S. 134 (1923); *Weiss v. Stearn*, 265 U.S. 242 (1924); *Marr v. United States*, 268 U.S. 536 (1925), in order that there be a realization of income and has held that there is a substantial change when assets are transferred to a corporation in exchange for its shares, these cases lend support to the conclusion that there is a transfer for a consideration when property is transferred to a corporation in return for the latter's shares.

The additional argument that the legislature intended the transactions discussed herein to be considered "sales" can be based upon the fact that the "occasional sale" exemption seems to deal with these transactions and that, if these were not "sales", there was no need to provide for an exemption.

It is difficult to determine what the administrative practice is. Compare Letter of Sales Tax Counsel, Sept. 8, 1955, 2 P-H CAL. STATE & LOCAL TAX SERV. ¶ 23,783-Y with Letter of Sales Tax Counsel, July 23, 1953, 2 P-H CAL. STATE & LOCAL TAX SERV. ¶ 21,222.15.

⁷⁸ Enacted in California. CAL. CORP. CODE §§ 15001-45.

⁷⁹ See Ballantine, *Adoption of Uniform Partnership Act in California*, 17 CALIF. L. REV. 623 (1929).

⁸⁰ *Reed v. Industrial Acc. Comm'n*, 10 Cal. 2d 191, 73 P.2d 1212 (1937); *Park v. Union Mfg. Co.*, 45 Cal. App. 2d 401, 114 P.2d 373 (1941). But see *DeMartini v. Industrial Acc. Comm'n*, 90 Cal. App. 2d 139, 202 P.2d 828 (1949) (recognizing partnership as an entity for certain purposes). For a discussion of the nature of the partnership under the Uniform Partnership Act, see *Helvering v. Smith*, 90 F.2d 590 (2d Cir. 1937).

⁸¹ CAL. REV. & TAX. CODE § 6006.5(b). The section is not free from ambiguity inasmuch as it provides in part "partners . . . holding an interest in a corporation or other entity . . ."

exchange for an interest therein has transferred property for a consideration. Once the transfer is complete, he no longer can transfer any specific interest in the transferred assets to another;⁸² in exchange for the transferred property he has become a tenant in partnership in all the assets of the partnership⁸³ and has received a right to participate in the management and control of partnership business and to share in the profits therefrom.⁸⁴ The legal relationship of the transferor to his asset before and after the transfer to the partnership is quite different. Thus, upon analysis of the rights and duties flowing from the Uniform Partnership Act, one cannot state with certainty that there has been no "sale".⁸⁵ Interestingly, the State Board of Equalization has taken the position that a transfer by a sole proprietor of a partial interest in his business would be taxable⁸⁶ while rejecting the taxability of a transfer of property to a partnership by way of contribution to the capital of the partnership.⁸⁷ The Board's position in the latter situation is based on the theory that there is no "sale".

2. Reorganization of Business Enterprises

With regard to the reorganization of business enterprises the first question is whether there is a "sale" when two corporations undergo a statutory

⁸² CAL. CORP. CODE § 15025.

⁸³ *Ibid.*

⁸⁴ CAL. CORP. CODE § 15026.

⁸⁵ *But cf. McElhinney v. Belsky*, 165 Pa. Super. 546, 69 A.2d 178 (1949), wherein the court held that an original contribution of capital to a partnership was not a transfer and even if a transfer would not be for a consideration. Under the federal income taxes, contribution of assets in the formation of a partnership has never been held to result in a realization of a gain or a loss. For a discussion of the administrative practice, see *Helvering v. Walbridge*, 70 F.2d 683 (2d Cir. 1934), *cert. denied*, 293 U.S. 594 (1934). See also MAGILL, *TAXABLE INCOME* 134-45 (rev. ed. 1945), where it is argued that the contributing partner parts with his property and acquires a distinctly new interest so that gain or loss is realized; LITTLE, *FEDERAL INCOME TAXATION OF PARTNERSHIPS* 25-26 (1952): "Once the property has been contributed to the partnership, the contributing member is immediately faced with the question of whether or not gain or loss will be realized and recognized upon the transfer. The solution of this problem will in turn depend upon whether or not the partnership is considered an entity for this purpose. If so, the contribution to it of property at an agreed value in excess of the contributor's income tax basis therefor would result in taxable gain. Happily, no such result is likely to occur. The Commissioner of Internal Revenue has long taken the position that no gain or loss will be realized as a result of the contribution of property to a partnership.

"This result is obtained, of course, by an application of the aggregate concept of partnerships. The individual's contribution is, in effect, a mere transfer to himself *qua* partner, and to say he has realized a gain or loss on the transaction would be tantamount to saying he could realize gain or loss by selling to himself. It is interesting, nevertheless, to note that neither the Bureau nor the judiciary has ever attempted to carry this theory to its logical extreme. If a partnership is a true aggregate of its individual members, the contributing partner not only transfers property to himself: he transfers an undivided interest in it to each other partner."

⁸⁶ Letter of Sales Tax Counsel, June 22, 1953, 2 P-H CAL. STATE & LOCAL TAX SERV. ¶ 21,222.15.

⁸⁷ Letter of Sales Tax Counsel, Nov. 24, 1952, 2 P-H CAL. STATE & LOCAL TAX SERV. ¶ 21,141.10.

consolidation and form a new corporation. Support for the conclusion that there is no sale may be found in the federal stamp tax cases which have refused to find a "sale" upon transfer of real property in consolidation or merger, at least in the absence of any assumption of indebtedness by the resulting corporation, on the ground that the transfer occurs by operation of law.⁸⁸ A contrary conclusion, however, is suggested by the following approach. The parties to the consolidation negotiate with each other and voluntarily enter into the agreement to consolidate.⁸⁹ The statutory consolidation is a device by which two or more corporations may combine without resort to the cumbersome procedure of a sale of assets to a newly formed corporation. The resulting corporation is a new entity,⁹⁰ and if the separate entity concept is to be maintained, the result here would be no different from that relating to the transfer of assets by individuals upon the formation of a corporation.

A second question in the reorganization area is whether a statutory merger results in a "sale". The essence of a statutory merger is so similar to that of a consolidation that a like result would obtain. The assets of the merging corporation are being transferred in exchange for the shares of the surviving corporation. Although there is an agency opinion that statutory mergers are not subject to sales tax liability,⁹¹ it is again uncertain whether the nontaxability is due to an unwillingness to recognize a "sale" or is attributable to the "occasional sale" exemption.

The "reorganization" of partnerships remains to be explored. The problems relating to the addition or substitution of a new partner are more complex than those in the corporate area. When a new partner is added and he contributes tangible personal property, the problem is whether there is a "sale" by the new partner and whether there also might be a "sale" by the existing partnership or by its members. Technically, at least for some purposes, there is a dissolution of the old partnership and the formation of a

⁸⁸ In *United States v. Seattle-First Nat'l Bank*, 321 U.S. 583, 590 (1944), the court held: "Nor can the realty be said to have been 'sold' or vested in a 'purchaser or purchasers' within the ordinary meanings of those terms. Only by straining the realities of the statutory consolidation process can respondent be said to have 'bought' or 'purchased' the real property. That we are unable to do."; see also *Rochelle Inv. Corp. v. Fontenot*, 34 F. Supp. 118 (E.D. La. 1940). *But cf.* *The Great Western Ry. v. The Comm'rs of Inland Revenue* [1894] 1 Q.B. 507 (merger held to involve a sale).

⁸⁹ See, e.g., *Niagara Hudson Power Corp. v. Hoey*, 117 F.2d 414 (2d Cir.), *cert. denied*, 313 U.S. 571 (1941), in which the court held: "Nor can these cases be distinguished as to the voluntary nature of the transfer, since the consolidation of plaintiff's constituents was brought about by the resolutions of their directors and votes of their stockholders." *Id.* at 416.

⁹⁰ *Ibid.*; see also BALLANTINE, CORPORATIONS 680 (rev. ed. 1946).

⁹¹ Letter of Sales Tax Counsel, Apr. 29, 1957, 2 P-H CAL. STATE & LOCAL TAX SERV. ¶ 23,791-N.

new partnership.⁹² If the partnership is treated as an entity, it would logically follow that there is a transfer by the old entity to the new entity as well as a transfer by the new partner to the new entity.⁹³ If the transaction is analyzed on the basis of the change in legal relationships under the Uniform Partnership Act without regard to the characterization of a partnership as either an "entity" or an "aggregate", the problem with regard to the old partnership property is more difficult. Partnership property is held in tenancy in partnership by the partners and, according to the Uniform Partnership Act, the partners are the co-owners of such property.⁹⁴ If the attributes of such tenancy are examined, the rights of an individual partner in any specific partnership property are sharply curtailed. Thus, even though the partners are described as the co-owners, the ownership of the property may still be consistent with the entity theory, and the transfer of such property to the new partnership may be a "sale" of the entire interest therein to the new partnership.⁹⁵

On the other hand, if the aggregate theory is accepted⁹⁶ the old partners are still co-owners of the partnership property transferred to the new partnership but with one difference—the addition of a new co-owner. By the same token, the old partners have acquired an interest as tenants in partnership in the property contributed by the new partner. Thus, although the argument that there is a transfer for consideration can be made without undue strain, the "sale" would consist of only partial interests in the various items of property. But can the old partners be considered to be "retailers" when the partnership was engaged in the retail business? Probably so, since each is engaged in the retail business conducted by the partnership.⁹⁷

Finally, if a partner assigns his interest in the partnership to a third party, the assignee acquires only the right to receive the profits to which the assigning partner would have been entitled, and upon dissolution, to receive his assignor's interest.⁹⁸ In this situation, it would seem that the partner, rather than selling tangible personal property, has sold an intan-

⁹² *Ellingson v. Walsh, O'Connor & Barneson*, 15 Cal. 2d 673, 104 P.2d 507 (1940); *Shunk v. Shunk Mfg. Co.*, 86 Ohio App. 467, 93 N.E.2d 321 (1949); CRANE, *PARTNERSHIP* 470 (2d ed. 1952).

⁹³ *Cf. Niagara Hudson Power Corp. v. Hoey*, 117 F.2d 414 (2d Cir.), *cert. denied*, 313 U.S. 571 (1941), in which the court in holding that there was a transfer of assets in a statutory consolidation used the following language: "But in legal jargon a change of ownership, terminating rights and other relations in one entity and creating them in another, is the essence of 'transfer' . . ." *Id.* at 416. *But cf. McElhinney v. Belsky*, 165 Pa. Super. 546, 69 A.2d 178 (1949) (no "true transfer" when property contributed to partnership capital).

⁹⁴ CAL. CORP. CODE § 15025.

⁹⁵ *Parker v. Rolfe*, 167 Ark. 245, 267 S.W. 775 (1925); CRANE, *PARTNERSHIP* 198 (2d ed. 1952); BALLANTINE, LATTIN & JENNINGS, *CORPORATIONS* 19-20 (1953).

⁹⁶ *Commissioner v. Whitney*, 169 F.2d 562, 567 (2d Cir.), *cert. denied*, 335 U.S. 892 (1948).

⁹⁷ See CAL. CORP. CODE §§ 15018, 15009.

⁹⁸ CAL. CORP. CODE §§ 15025(b), 15027.

gible—an interest in the partnership. The transaction thus falls outside the purview of the sales tax.

3. Dissolution

In the event of distribution in kind to the shareholders upon corporate liquidation, it can be argued with much force that there is no "sale" by the corporation either because there is no exercise of volition on the part of the corporation in making the transfer after fifty per cent or more of the shareholders have voted to dissolve the corporation⁹⁹ or because there is no consideration.¹⁰⁰ A distinction between a sale and a liquidation has also been made on the ground that the liquidation is accomplished by the unilateral act of the corporation.¹⁰¹ A further argument is that the liquidation of the corporation marks the termination of the investment by the shareholders and merely converts their equitable ownership into a direct ownership.¹⁰²

If, however, a transfer of tangible personal property by an individual to a corporation in exchange for the latter's shares constitutes a "sale" because the individual has received a "bundle of rights" different from what was inherent in direct ownership of the property,¹⁰³ has not the shareholder in accepting a distribution of tangible personal property in exchange for the relinquishment of his rights as a shareholder transferred such rights for a consideration? Has not the corporation then transferred the assets for

⁹⁹ CAL. CORP. CODE § 4600.

¹⁰⁰ *Tide Water Associated Oil Co. v. Jones*, 57 F. Supp. 482 (W.D. Okla. 1944), *appeal dismissed*, 148 F.2d 340 (10th Cir. 1945); *Socony-Vacuum Oil Co. v. Sheehan*, 50 F. Supp. 1010 (E.D. Mo. 1943), *appeal dismissed*, 144 F.2d 252 (8th Cir. 1944). These cases decided that there is no sale under the federal stamp tax provisions even though there was assumption of indebtedness by the transferee since the assets received in liquidation exceeded the debts assumed. See also *State v. Green*, 88 So.2d 493 (Fla. 1956). There are cases, however, which have held that there is a "sale" upon corporate liquidation to the extent of assumption of indebtedness by the shareholders. *Greyhound Corp. v. United States*, 208 F.2d 858 (7th Cir. 1954); *R. H. Macy and Co. v. United States*, 107 F. Supp. 883 (S.D.N.Y. 1952); *Deer Park Pine Industry, Inc. v. County of Stevens*, 46 Wash. 2d 852, 286 P.2d 98 (1955). The rationale of the latter cases is that the shareholders have in effect purchased the property from the creditors of the liquidating corporation who had a paramount right to the property.

¹⁰¹ *Hay v. Commissioner*, 145 F.2d 1001 (4th Cir. 1944), *cert. denied*, 324 U.S. 863 (1945); see *Estate of Traung*, 30 Cal. 2d 811, 185 P.2d 801 (1947).

¹⁰² In *Deer Park Pine Industry v. County of Stevens*, 46 Wash. 2d 852, 286 P.2d 98 (1955), the court observed: "... There is no conveyance for a valuable consideration, taxable under the ordinance and statutes we are considering, where a change of title to real property is effected solely as a result of its distribution to stockholders of a solvent corporation in the process of dissolution, except as hereafter noted. . . . The change in title is but the fruition of a right which accrued to the stockholder at the time the stock was acquired.

"... Assuming, however, that the certificates were surrendered and returned to the stock-certificate book, . . . their surrender is, at this stage of the proceeding, a matter of form and not of substance. The stockholder neither gained nor lost anything thereby."

¹⁰³ See text corresponding to notes 76 and 77 *supra*.

a consideration in securing the cancellation of such shareholders' rights outstanding against it?¹⁰⁴

As for the distribution of tangible personal property to the partners upon winding up a partnership, treatment identical to that given to a dissolution of a corporation should be accorded if the partnership is regarded as a separate legal entity. If, however, the entity concept is not accepted and if the various items of partnership property are distributed to the former partners as tenants in common according to their relative interest in the partnership, the partners continue to enjoy direct ownership and the quantitative interest of the partners in each property will remain the same after the liquidation. Thus, the conversion from a tenancy in partnership to a tenancy in common might not even be a transfer. Where the items of partnership property are allocated among the partners as sole owners, however, there is a mutual relinquishment of partial interests in the various items of property. A technical analysis of the legal effect of the transaction tends to the conclusion that there is a transfer for a consideration.¹⁰⁵

B. Are These Transactions Exempt as "Occasional Sales"?

Even if the conclusion reached is that a sale is involved in the transactions considered above, the "occasional sale" exemption may exclude all or some of them from sales taxation. Insofar as is relevant here section 6006.5(b) defines an "occasional sale" as follows:¹⁰⁶

Any transfer of all or substantially all the property held or used by a person in the course of such an activity [requiring a seller's permit] when after such transfer the real or ultimate ownership of such property is substantially similar to that which existed before such transfer. For the purposes of this section, stockholders, bondholders, partners, or other persons holding an interest in a corporation or other entity are regarded as having the "real or ultimate ownership" of the property of such corporation or other entity.

The first requisite of the exemption is a "transfer of all or substantially all the property held or used in the course of an activity for which a seller's permit is required." Although the statute does not specify a percentage, the

¹⁰⁴ Compare *Commissioner v. Boca Ceiga Development Co.*, 66 F.2d 1004 (3d Cir. 1933); *Commissioner v. S.A. Woods Mach. Co.*, 57 F.2d 636 (1st Cir.), *cert. denied*, 287 U.S. 613 (1932), with *Lucius Pitkin, Inc.*, 13 T.C. 547 (1949); *Lencard Corp.*, 47 B.T.A. 58 (1942) (cases making a distinction between a transfer as a sale of assets by the corporation in exchange for its shares and a transfer to effect capital readjustment).

¹⁰⁵ The State Board of Equalization seems to have distinguished between a transfer of partnership assets to the members as tenants in common in the same ratio as their former interests in the partnership and a transfer of partnership assets to one partner, only the former being considered as a nontaxable sale. See *Letters of Sales Tax Counsel*, May 7, 1956 and Oct. 5, 1956, 2 P-H CAL. STATE & LOCAL TAX SERV. ¶¶ 23,787-G, 23,788-Y.

¹⁰⁶ CAL. REV. & TAX. CODE § 6006.5(b).

State Board of Equalization has used eighty per cent as the minimal transfer necessary to satisfy the exemption.¹⁰⁷ Thus a "seller" transferring tangible personal property upon formation of a corporation or a partnership must meet the eighty per cent requirement to come within the exemption. A caveat may be noted. The exemption requires a transfer of all or substantially all "the property." "Property" could include real, as well as tangible personal property, or it might refer to tangible personal property only. The State Board of Equalization in applying the eighty per cent figure seems to consider only tangible personal property.¹⁰⁸

This eighty per cent requirement can produce anomalous results. Suppose that *R* Corporation, a retailer, forms *S* Corporation as a subsidiary and transfers assets in return for the latter's shares. If the assets transferred were not "all or substantially all the property" of *R* Corporation, the "sale" is taxable. Modify these facts slightly and suppose that *R* Corporation forms *S* and *T* Corporations. "All or substantially all the property" of *R* is transferred to *S* and *T*. The result in this situation is uncertain. The transfers to *S* and *T* considered separately will not satisfy the requirement; together they will. If the latter interpretation is correct, *R* will be unwise insofar as the sales tax consequence is concerned to form a single subsidiary.¹⁰⁹ Likewise, a partial liquidation by a corporation or partnership may fail to meet the eighty per cent requirement and thus be subject to the tax.

The exemption as presently worded seems to result in a gross discrimination against those who have become retailers by virtue of the number, scope and character test, for example, by having sold obsolete equipment. Section 6006.5(b) restricts the exemption only to transfers of property held or used in the course of an activity for which a seller's permit is required.¹¹⁰ Because all or most of the property of such persons is not held or used in the course of selling obsolete property but rather in the course of their nonretail activity they will be denied the exemption even though all the other requirements of the section are met. Regular retailers, on the other hand, will receive an exemption for all the property held or used in the

¹⁰⁷ Letter of Sales Tax Counsel, Dec. 31, 1953, 2 P-H CAL. STATE & LOCAL TAX SERV. ¶ 21,222.35.

¹⁰⁸ Letter of Sales Tax Counsel, Jan. 24, 1955, 2 P-H CAL. STATE & LOCAL TAX SERV. ¶ 23,668.

¹⁰⁹ Formerly the Board required an 80% transfer to a single entity, Letter of Sales Tax Counsel, Mar. 29, 1955, 2 P-H CAL. STATE & LOCAL TAX SERV. ¶ 23,717; however, there has been a reversal in this position and presently the simultaneous transfer of all of the assets of a corporation to one or more wholly-owned subsidiaries is an exempt occasional sale. Letter of Sales Tax Counsel, Jan. 17, 1957, 2 P-H CAL. STATE & LOCAL TAX SERV. ¶ 23,789-Q.

¹¹⁰ When CAL. REV. & TAX. CODE § 6006.5(b) is read in conjunction with § 6006.5(a), it becomes apparent that the phrase "such an activity" appearing in § 6006.5(b) refers to an activity for which a seller's permit is required.

course of their principal activity—retail selling. This discrimination is wholly unjustified. Construction of section 6006.5(b) as merely setting forth examples of “occasional sales” rather than providing an exclusive enumeration would eliminate this inequity.

The second major requirement of section 6006.5(b) is that after the transfer “the real or ultimate ownership of such property” be “substantially similar to that which existed before such transfer.” The statute provides that “stockholders, bondholders, partners, or other persons holding an interest in a corporation or other entity are regarded as having the ‘real or ultimate ownership’ of the property of such corporation or other entity.” With respect to a sole proprietor who incorporates his business and becomes the sole shareholder of the corporation, little difficulty is presented.¹¹¹ But a problem does arise when two persons form a corporation, each transferring assets from his former retail business owned as sole proprietor. The problem is twofold: (1) whether the real or ultimate ownership remains substantially the same when the assets are no longer owned by them as sole owners, and (2) whether the shares must be distributed in proportion to the assets contributed.

As to the first, once it is assumed that a “sale” does not require the transfer of the entire interest in property but rather that a transfer of partial interest in tangible personal property is sufficient,¹¹² it is difficult to reach the conclusion that the “real and ultimate ownership” of the property transferred by *A* is the same when he no longer owns the property by himself. An argument for a contrary result would have to be based on construction of the phrase “all the property or substantially all the property held or used by a person” as alluding to the combined property of all persons making the original contribution of capital to the corporation. And the concept of substantial similarity of ownership would have to be viewed in terms of interest in the combined property both before and after the transfer. Only by so construing the statute would it be possible to say that the ownership of the property is substantially the same before and after the transfer. Under the plain meaning of the statute this interpretation is even more difficult in the situation where *A*, a retailer, contributes all his assets to the newly organized corporation while *B*, also a retailer, contributes only a small portion of the assets of his business. If the required similarity of ownership is determined by the combined property of *A* and *B*

¹¹¹ See Letters of Sales Tax Counsel, Jan. 7, 1953 and Mar. 25, 1954, 2 P-H CAL. STATE & LOCAL TAX SERV. ¶¶ 21,222.35, 23,527, indicating that the Board does not consider a qualitative change in ownership to result in a denial of the exemption.

¹¹² It appears that the State Board of Equalization would consider a sale of partial interest in tangible personal property a sale. Letter of Sales Tax Counsel, June 22, 1953, 2 P-H CAL. STATE & LOCAL TAX SERV. ¶ 21,222.15 (“Where a sole proprietor sells a one-fifth interest in his business to each of four parties, . . . a taxable sale results within the meaning of Section 6006”).

before and after the transfer, is *A*'s taxability determined by *B*'s contribution?¹¹³

The next question is whether the proportionate interest of *A* and *B* must be the same before and after the transfer. If some liberty is taken with the statutory provisions in order to reach the conclusion that the required similarity of ownership can be based on the combined property of *A* and *B*, it is not too difficult to extend the statute slightly further and accept the result that the proportion in which the shares are issued by the corporation need not bear any relationship to the value of the property contributed; only the identity, rather than the interest, of the respective owners before and after the transfer is important. The alternative is to choose either the "relative value" or "proportionate interest" test as developed by the courts under the former provisions of the federal income tax.¹¹⁴

Even if substantial similarity of ownership is determined by the identity of the transferors, there may be a difference between consolidation and merger. In the case of a consolidation, the constituent corporations are the transferors, thus substantial similarity may be determined by noting that the former shareholders of the constituent corporations are still the owners after the transfer to the resulting corporation. In the case of a merger, however, only the merging corporation is the transferor. And section 6006.5(b) requires that the real and ultimate ownership of the transferred property be substantially similar. Thus, if after the merger the shareholders of the merging corporation do not hold eighty per cent or more of the shares of the surviving corporation, the exemption would be denied.¹¹⁵ This distinction between the consolidation and merger is indefensible and can only be regarded as another statutory aberration. It should be observed that the problem just discussed would not arise with respect to a partnership taking

¹¹³ CAL. REV. & TAX. CODE § 6006.5(b) provides: "Any transfer of all or substantially all the *property* held or used by a person in the course of such an activity when after such transfer the real or ultimate ownership of such *property* is substantially similar to that which existed before such transfer." (Emphasis added.) The word "property" must refer to the same items of property. Yet, in order to grant an exemption to *A*, one must construe the word "property" when it makes its first appearance as alluding only to *A*'s property, whereas, when it makes its second appearance, it must be interpreted as referring to the combined property of *A* and *B*, both before and after the transfer.

¹¹⁴ See Note, 62 HARV. L. REV. 1238 (1949) for a discussion of these tests developed by the courts in reference to INT. REV. CODE OF 1939 § 112(b)(5), 53 STAT. 37. Under the present provisions, nonrecognition of gain or loss no longer depends upon such tests. INT. REV. CODE OF 1954, § 351(a); see the report of the Senate Finance Committee, S. REP. NO. 1622, 83d Cong., 2d Sess. 264 (1954).

¹¹⁵ The transferor must have at least an 80% interest in the transferee to satisfy the continuity of ownership test. Letter of Sales Tax Counsel, Dec. 10, 1953, 2 P-H CAL. STATE & LOCAL TAX SERV. ¶ 21,222.35.

in a new partner, since there will be mutual transfers regardless of the theoretical nature of the partnership.

In the dissolution of a corporation, the situation presented is inverse to that in formation. Unity of ownership in all the property is being proliferated when corporate assets are divided among the shareholders. The discussion with respect to the determination of "real or ultimate" ownership in the case of formation¹¹⁶ is equally applicable. Where, however, the assets are distributed to the shareholders as co-owners in the proportion in which they held shares, for example, where they plan to continue the same business as a partnership, it would seem, without question, that this requirement is satisfied.

The final problem for consideration is the nature of the interest which the transferors must hold in order to be classed as "owners," that is, whether the individual transferors may receive preferred shares or bonds or whether they must receive voting shares in order to satisfy the continuity of ownership requirement. The statute is ambiguous. Because "stockholders" and "bondholders" are mentioned in section 6006.5(b) without further qualification, it may be that an exchange of property for non-voting preferred shares or even bonds would suffice to meet the test of "real or ultimate" ownership. But if the legislature intended that there be continuity of ownership, it would seem that voting control should be considered.¹¹⁷

CONCLUSION

In conclusion, further legislation appears desirable both in regard to (A) the sale of an entire business and (B) the formation, reorganization, and dissolution of business enterprises. In the ensuing paragraphs, the relevant policy considerations will be summarized and particular stress will be laid on suggested legislative changes.

A. The Sale of an Entire Business

As our discussion has disclosed, the sales tax consequence of a transfer of capital assets in the sale of an entire business frequently depends upon (1) whether prior or subsequent retail sales are made and (2) the nature of the business in which the seller is engaged. In many cases, it may seem that the "tail is wagging the dog,"¹¹⁸ and the result may often seem harsh.

¹¹⁶ In text corresponding to notes 112-14 *supra*.

¹¹⁷ See *J.H. Baxter & Co. v. State Bd. of Equalization*, 2 P-H CAL. STATE & LOCAL TAX SERV. ¶ 23,786-T (Sacramento Super. Ct. No. 99093, 1956, where the court rejected ownership of debentures of the transferee as fulfilling the requirements of § 6006.5(b)).

¹¹⁸ The taxpayer in the *Market Street* case had received approximately \$100,000 from retail sale of scraps and obsolete equipment. The sales tax attributable to the retail sales including the sale to the city was approximately \$60,000. The taxpayer was spared interest and penalty in the amount of about \$28,000 because of its reliance on an administrative ruling which exempted the sale of an entire business from the sales tax at the time of sale to the city.

A situation could easily arise where the gross receipts from the retail sale of only a few

The answer, however, is not simply to exempt the sale of an entire business. Basically the problem is one of harmonizing the legislative policies of (1) taxing even those persons who are not considered to be in the retail selling business by the usual community standard but who make incidental retail sales, and (2) exempting persons who make only a very few retail sales. The justification for the former policy can be found in the fact that the retail sales tax is fundamentally a consumer's expenditure tax and the burden borne by the consumer should not depend upon the volume of business conducted by the seller. Thus, as long as the legislative policy is to tax persons making incidental retail sales, the sale of an entire business cannot fairly or logically be exempt.

The exclusion of persons making only a very few retail sales can be explained only in terms of administrative convenience. The formula presently used is the "number, scope and character" test but the unpredictability of the tax consequences under this test may frequently result in hardship; in a particular case, the seller, although able to "pass on" the tax to the purchaser, may fail to do so. At the expense of arbitrariness, it might be better to define a "retailer" in terms of a definite number of retail sales.

Moreover, a distinction should be made as to the type of property sold by persons engaged in the regular business of retail selling. The sale of used capital assets by such retailers—as distinguished from the sales of items of property regularly sold in his retail operation—should be taxed on the same basis as sales of similar property made by those not engaged in a regular retail selling activity. Presently, the regular retailer, and ultimately his consumer, is unduly burdened; this discrimination is magnified when a sale is made of an entire business.¹¹⁹

Although the above suggestions do not completely solve the problem inasmuch as taxability of the sale of an entire business will still depend on whether the seller makes a sufficient number of sales of like property to become a "retailer" of such property, an equitable solution short of taxing every retail sale made by anyone is impossible. So long as administrative expediency is to be served, a certain amount of arbitrariness will obtain, but the above suggestions have the merit of predictability and of fairness among normal retailers and retailers who become such only because of the "number, scope and character" of their retail sales, with the resulting equity among their purchasers.

A possible alternative solution to this problem would be to set an arbi-

items of obsolete equipment which would make the seller a retailer would be insignificant when compared to the tax which would apply to the transfer of tangible personal property in a sale of the entire business.

¹¹⁹ Similar observations may be made for the wholesaler who sells his used capital assets.

trary number of sales which would make the seller a retailer but provide that even one retail sale of a certain magnitude would be taxable. This latter suggestion calls for a radical departure from the present framework of the sales tax, but appears to be the most equitable one subserving the conflicting policies previously mentioned. The administrative cost, of course, must be considered in setting the maximum on the single allowable tax-free retail sale.

B. The Formation, Reorganization and Dissolution of Business Enterprises

It is unfortunate that the Sales and Use Tax Law leaves the problems we have discussed in regard to the taxation of the formation, reorganization and dissolution of business enterprises in the present state of confusion. The taxpayer is entitled to some degree of certainty in order that he may be apprised of tax consequences in planning these transactions; he is also entitled to know when he should seek reimbursement from the purchaser. While the State Board of Equalization attempts to offer some direction in this field, the taxpayer can ill afford to rely blithely on the Board's interpretive expressions; the Board is not estopped from later asserting a tax on transactions previously deemed exempt by it.¹²⁰ Thus, a taxpayer may well rely on a Board interpretation exempting his particular transaction from the sales tax only to find that he has irrevocably lost his opportunity to pass on the tax to his purchaser if the court decides that the Board was correct in making a later assessment.

In order to achieve certainty, the legislature should expressly provide that a transfer of tangible personal property in exchange for the shares of the transferee corporation or for an interest in the transferee unincorporated enterprise is a "sale". Even if the legislature desired to make any or all of the transactions in this area nontaxable, the better approach would seem to be to provide that they are "sales" and then write specific exemptions for them. By this method, the basic definition of a sale would be little disturbed and unforeseen consequences upon other transactions would be avoided.

Attention is now directed to the "occasional sale" exemption. It is difficult to imagine a section more poorly drafted and capable of mischief than

¹²⁰ *Market Street Ry. v. California State Bd. of Equalization*, 137 Cal. App. 2d 87, 290 P.2d 20 (1955). In that case, the taxpayer relied on a ruling of the State Board of Equalization which exempted the transaction in question. Subsequently, the ruling was amended to make such transactions taxable. The court found the earlier ruling to be erroneous and required the taxpayer to pay the principal amount of the tax. It did, however, excuse the taxpayer from paying any interest and penalty.

For a discussion of estoppel against government in tax matters, see *United States Fidelity and Guaranty Co. v. State Bd. of Equalization*, 47 Cal. 2d 384, 303 P.2d 1034 (1956).

section 6006.5(b). One may suspect that the section was hastily drafted to cover a specific transaction without regard to collateral consequences. First, the desirability of requiring the transfer of all or substantially all the property in all situations is questionable. The policy, if any, behind section 6006.5(b) seems to be one of removing the burden of the sales tax on a technical sale between conceptually separate entities when little economic change is effected by the transfer. The reason for the requirement of a transfer of all or substantially all the property is probably to avoid the exemption of regular retail sales within the business family. While one may disagree with the taxation of even the latter sales on the ground that little economic change is effected, if these sales are to be removed from the exemption, the proper method is not to require a transfer of all or substantially all the property in order to qualify for the exemption; it would appear sufficient to provide that transfers of tangible personal property as consideration for shares of the transferee corporation or for an interest in the transferee unincorporated enterprise shall be exempt so long as continuity of ownership is maintained. By so providing, the present indefensible discrimination against transactions like that in which a parent corporation transfers only a portion of its business to a wholly-owned subsidiary will be eliminated.

On the other hand, if substantial continuity of ownership is required in all cases, an exemption may be denied to one or more of the contributors to a newly organized business enterprise or in a merger or consolidation. It would seem that when *A* and *B*, retailers, transfer their respective businesses to a new corporation or partnership, the merits of granting an exemption to them are as great as when a sole proprietor incorporates his business. Thus, an exemption should be granted without regard to continuity of ownership when all or substantially all the assets are transferred in exchange for shares of the transferee corporation or an interest in the transferee unincorporated enterprise so long as the transferor receives in exchange a substantially equivalent proportion of the shares or interest which the transferred property bears to the total value of the property of the corporation or other enterprise after the transfer.¹²¹ And in order to exempt distributions in kind, exemptions should be fashioned for the transfer of

¹²¹ The above suggestion will result in a denial of the exemption in a situation where *A* corporation and *B* corporation contribute only a portion of their assets to form *C* corporation. While it may be argued that these transactions should be exempt, the resolution of these distinctions will depend ultimately upon the extent to which the legislature desires to exempt these transactions. It would seem, however, that where *D*, an individual retailer, transfers only a portion of the tangible personal property of his business to a corporation in exchange for the latter's shares, it is a close question as to whether the transaction should not be treated similarly to a transfer for any other consideration.

tangible personal property in cancellation of shares or termination of the interest of the transferee in the unincorporated enterprise.¹²²

Moreover, the exemption provisions should clarify the nature of the interest which must be received to satisfy the requirement of continuity of ownership. Presently, it may be possible for the transferor to obtain an exemption if he owns only bonds of a solvent transferee corporation. The continuity of ownership test should be tightened to require that the transferor own not only 80% of the total outstanding securities but also 80% of the voting control. Debt security holders should not be deemed to be the real and ultimate owners of a corporation unless and until such time as they can effectively control the disposition of corporate assets.

Of course the other ambiguities and inequities indicated in the discussion of the present provisions should be eliminated.

Finally, because a transfer of an intangible is not subject to the sales tax, avoidance schemes will inevitably be devised unless some provision is added to close the loophole. The exemption granted under the "occasional sale" section should be denied if the principal purpose of the transaction was to avoid the payment of the tax. Where a transaction has qualified for an exemption as an "occasional sale", the transferor who has received shares of the transferee corporation or an interest in an unincorporated enterprise should have the burden of proving that the transaction did not have as its principal purpose the avoidance of the payment of sales tax if he exchanges the shares or interest for other property within a specified period after the conclusion of the exempt transaction. Similar consideration should be given to transfers by business enterprises to transferees as dividends, or liquidating distributions to prevent "step" transactions.¹²³

The above suggestions would add clarity in this complex area and inject a measure of fairness by removing the tax burdens upon legitimate business formations, combinations and dissolutions involving minimal economic changes. At the same time they would result in making enterprises bear the burden of maintaining separate legal entities by subjecting transfers which are akin to the usual concept of "sales" to the tax.

¹²² Compare the rules promulgated in Washington with regard to these problems, Rule 106, CCH WASH. TAX REP. ¶ 68-506; also the statutory exemptions in Oklahoma, OKLA. STAT. tit. 68, § 1251d(f) (1951); and in Indiana, IND. STAT. ANN. § 64-2601(m) (Burns Supp. 1957).

¹²³ The enforcement of the above suggested provision could be facilitated by requiring the person claiming the exemption to file an exemption certificate. Such a certificate would permit the Board to follow subsequent transactions if it so desired.