

Memorandum

395.2177

To : Mr. Rusty Dane  
Out-of-State District Office

Date: October 21, 1997

From : Warren Astleford  
Senior Tax Counsel

Subject: *O--- D---, Inc.*  
*SS -- XX-XXXXXX*

This is in response to your September 9, 1997 memorandum asking how tax applies to the transfer of stock and cash by O--- D---, Inc. (ODI) pursuant to a November 28, 1994 declaration of a stock dividend. The auditor provides the following facts:

“[ODI] declared a dividend of 32 shares of common stock for each share of common stock held (prior to 11/28/94) on November 28, 1994, to each owner of stock (F--- E---, Inc. [(F---)] and G--- P---, Inc. [(G---)] each held a 50% ownership of the company, represented by common stock). The value of the stock dividend of 800,000 shares to be offered to each stockholder was equal to the actual value of the company (stated as \$14.625 per share per Board of Directors memo). The dividend election to G--- and F--- . . . included an option to receive a cash dividend.

“F--- . . . knew prior to the declaration of this dividend that G--- . . . was going to take the cash dividend option. In order to fund this dividend, additional short and long-term debt (liabilities) were assumed by . . . ODI under the authority of ODI’s Board of Directors. This distribution caused the ultimate ownership of ODI, that being the stockholders, to change substantially, by approximately 47%.

“[ODI] filed new articles of incorporation with the Oklahoma secretary of state just before the payment of this dividend.”

Discussion

Sales tax is imposed on a retailer’s gross receipts from the retail sale of tangible personal property inside this state unless the sale is exempt from taxation by statute. (Rev. & Tax. Code § 6051.) When sales tax does not apply, use tax is imposed on the storage, use or other consumption of property purchased from a retailer for use inside this state. (Rev. & Tax. Code §§ 6201, 6401.) The sale of stock of a corporation is not a sale of tangible personal property and is not subject to tax. (Reg. 1595(a)(6); BTLG Annot. 395.1250 (5/8/87).) The

purchase of stock is also not a purchase of tangible personal property even where the stock purchase is treated as an asset acquisition for federal income tax purposes. (*Id.*)

ODI's transaction involves both the transfer of stock and cash to its shareholders as well as a percentage change of ownership in ODI. For purposes of clarity, we have separately addressed how tax applies each portion of this transaction.

#### Stock/Cash Distribution

ODI declared a stock dividend to its two shareholders, F--- and G---, on November 28, 1994. Each shareholder had the option to receive cash in lieu of the stock at a set price of \$14.625 per share.<sup>1</sup> G--- opted to take the cash which in turn required ODI to raise cash in order to satisfy its dividend obligation to G---. We understand that ODI raised this money by obtaining both long and short term loans from a third party lender. ODI then distributed a cash dividend to G--- and a stock dividend to F---. We assume that neither G--- nor F--- assumed any debts or obligations of ODI as part of ODI's respective dividend distributions.

ODI's distribution of stock and cash is not a taxable transfer for two reasons. First, stock certificates or cash are not regarded as tangible personal property for sales and use tax purposes. (See, generally, BTLG Annots. 395.1250 (5/8/87), 395.1992 (3/29/68).) The stock certificate is indicia of ownership in a corporation and the cash is a representation of a value set by the federal government. This means that ODI did not transfer any tangible personal property to F--- or G--- by virtue of the stock and cash distribution. Second, we understand that neither F--- nor G--- provided any consideration to ODI as part of the transfer of the stock or cash. That is, we assume that F--- or G--- did not promise to provide a benefit to ODI that it was not otherwise entitled to as an inducement for the stock/cash transfer. Without consideration, there can be no sale. (See Rev. & Tax. Code § 6006(a).) Thus, under these facts, ODI did not make a sale, nor transfer tangible personal property as part of its cash and stock dividend distribution. Tax does not apply to this portion of the transaction.

#### Percentage Change In Ownership

Deloitte & Touche's February 17, 1995 letter to F--- and G--- provides that each owned 25,000 shares of ODI prior to ODI's November 28, 1995 declaration of a stock dividend. Upon ODI's distribution, F--- and G--- owned 825,000 and 25,000 shares of ODI, respectively. We again note that ODI alone obtained the loans necessary to fund its payment in lieu of stock to G--- and, we assume, received no consideration whatsoever from G--- or F--- for the stock/cash distribution. We further assume that ODI's distribution consisted entirely of stock or cash and that no tangible personal property was transferred by ODI to F--- or G---.

The distributions to F--- and G--- resulted in a change in the amount of stock owned by each party. The key to what occurred, however, is the fact that the ownership of ODI's tangible

<sup>1</sup> We understand that ODI intended this transaction to qualify as a federal income tax exempt reorganization pursuant to Internal Revenue Code section 368(a)(1)(E).

personal property did not change. F--- increased its percentage ownership of the stock of ODI, but did not ever obtain any ownership interest in the assets owned by ODI. The ownership of stock is very different than the ownership of tangible personal property and the ownership of one does not equate to ownership of the other. This means that F---'s increased ownership of ODI stock did not result in ODI selling any of its tangible personal property to F---.<sup>2</sup> Thus, we do not regard the percentage change in stock ownership by the parties as subject to tax.

Our opinion above is based on the facts, representations, and understandings as set forth above. If any of these facts, representations, or understandings are incorrect, our opinion might be different. If you have any further questions or believe we have misstated or omitted any relevant facts, please write again.

WLA:cl

cc: Out-of-State District Administrator (OH)

<sup>2</sup> In reaching this conclusion, we further assume that the stock dividend is not part of a series of transactions undertaken between F---, G---, and/or ODI for the purpose of avoiding or altering the California sales or use tax liabilities between those parties. (See, e.g., BTLG Annot. 395.1840 (3/1/66; 7/28/86); 570.0100 (1/24/58); 395.2000 (11/19/74) (the intervening steps of a step transaction will be disregarded).) For example, we assume that F--- will not then dissolve ODI pursuant to a non-taxable liquidating distribution which would have been a taxable transaction had ODI transferred its assets directly to Franklin from the outset.