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STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
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January 14, 1997

Mr. J--- P. K---
G--- & J--- LLP
--- --- Plaza
Suite XXX
--- ---, CA XXXXX-XXXX

Re: T---, Inc. and Affiliates

Dear Mr. K---:

This responds to your letter dated October 9, 1996. You indicate that one of the entities involved in the factual situation which you describe in your letter, and on which you request our legal opinion, is currently being audited by the State Board of Equalization. When a taxpayer is in the process of an audit, it is the policy of the Legal Division to not issue a taxpayer opinion letter concerning issues which may be the subject of that audit. However, for your general guidance, we will provide you with some general information concerning your inquiry.

Under the Sales and Use Tax Law, the transfer from one person to another of title or possession of tangible personal property for consideration is a sale. (Rev. & Tax. Code § 6006(a).) Consideration is defined to include any benefit conferred or agreed to be conferred, upon the promisor, by any other person, to which the promisor is not lawfully entitled, or any prejudice suffered, or agreed to be suffered, by such person, other than such as he is at the time of consent legally bound to suffer, as an inducement to the promisor. (Civ. Code § 1605.)

Unless specifically exempted or excluded from taxation by statute, the gross receipts from such a sale of tangible personal property at retail are subject to tax. (Rev. & Tax. Code § 6051.) Since the definition of a "person" includes a corporation, the transfer of tangible personal property from one corporation to another for consideration is a sale, without regard to whether the corporations are related or not. (Rev. & Tax. Code § 6005.) The converse of this is that a transfer of tangible personal property between corporations (or other persons), where there is no consideration, is not a sale subject to sales tax under the Sales and Use Tax Law. Instead, such a transfer is a use by the transferor, and the usual rules regarding the application of use tax to the use of the property would apply.

It is our experience that when one corporation carries tangible personal property on its books as an asset, and that property is then transferred to a related entity, the transfer must be accounted for in some manner in the books of the transferor. The flip side is that the transferee must also account in its books for the transfer received and the resulting increase in its assets. If this is done by creating an inter-company debt, e.g., the transferor shows a credit due from the transferee and the transferee shows in its books a corresponding debt owed to the transferor, consideration has been paid. That is, if either the transferor, or transferee, or both have such bookkeeping entries, that would establish that there had been a taxable sale.

As we understand your description of the transactions of T---, Inc. and Affiliates, the inter-company transfers of tangible personal property between two wholly-owned, subsidiary corporations of T---, Inc. are balanced through the corporate parent's (T---, Inc.) equity account. It appears that the corporate parent's equity account is used as a third party clearing account. The use of such a device does not mean there is no consideration. Rather, the benefit conferred on or detriment suffered by the parent corporation by a credit or debit to its equity account is consideration to the subsidiary corporations which, in effect, each have agreed either to transfer a benefit or a detriment to the parent in exchange for receiving tangible personal property or foregoing remuneration for that tangible personal property from the other wholly-owned, corporate subsidiary of the parent. In other words, the benefit and detriment to the parent is consideration for the transfer of the tangible personal property and the resulting debt, and results in a sale. Payment of tax cannot be avoided, as your letter suggests, by the use of a "straw man" equity account of the parent.

The only time there is no consideration, and, thus, no sale subject to tax, is if the transferor balances the transaction solely within its own books, with no involvement of the books of any other entity, and the transferee similarly balances its own books with no involvement of any other entity. That is, there cannot be any credit, debt, or other payment created by virtue of the transfer, whether involving only the transferor and transferee or involving a third party, such as a parent or holding company of the two transferring entities. Since such is not the case here, it appears that the transfer of the tangible personal property from the one wholly-owned corporate subsidiary to the other is a sale which is subject to tax under the Sales and Use Tax Law.

A copy of this letter is being sent to the district office where the audit is in progress. If the audit staff believes that further review of the books of the audited entity or related entities is warranted, staff should conduct that further review.

In closing, we note that this is the third letter written by the Legal Division on the same issue and to the same taxpayer. We believe that any further analysis on this point is wholly audit related, and that any further concerns which you have in that regard should be directed to the audit staff.

I hope that this information is of assistance.

Sincerely,

Sharon Jarvis
Senior Tax Counsel

SPJ:rz

cc: Mr. Dennis Fox , MIC: 92
-- District Administrator - (--)
Mr. Dennis Goodman - --
Ms. Bernadette Lingley - --