JURISDICTION: **OKLAHOMA TAX COMMISSION**
CITE: **91-02-22-012 / PRECEDENTIAL**
ID: **P-89-153**
DATE: **FEBRUARY 22, 1991**
DISPOSITION: **DENIED**
TAX TYPE: **SALES**
APPEAL: **DISMISSED, S.Ct. 77,295**

ORDER

This comes on before the Oklahoma Tax Commission pursuant to regular assignment on the agenda. The Commission, having reviewed the facts and authorities presented therein, and being fully advised in the premises, finds and orders that the Findings, Conclusions and Recommendations of the Administrative Law Judge, filed herein on the 17th day of August, 1990, marked as Exhibit "A", attached hereto and hereby incorporated by reference as though fully set out herein, be and the same are hereby adopted as the Order of the Commission.

It is further determined that the statement of law contained herein is precedential in nature; thus, it is hereby ordered that this document be expunged of the protestant's name and identifying data, and that it be made available for public inspection at the M. C. Connors Building, 2501 Lincoln Boulevard, Oklahoma City, Oklahoma.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Protestant is represented by ATTORNEY 1 and ATTORNEY 2, Attorneys, and the Business Tax Division is represented by OTC ATTORNEY, Assistant General Counsel. A hearing was held in this matter, exhibits were received into evidence, and the case was submitted for a decision.

FINDINGS OF FACT

1. In 1988, PARTNERSHIP, a partnership, acquired a 99% partnership interest in GAS PARTNERSHIP from GAS COMPANY. PIPELINE COMPANY owned a 1% partnership interest in GAS PARTNERSHIP. GAS COMPANY owned 100% of the stock of PIPELINE COMPANY. PARTNERSHIP purchased 100% of the stock of PIPELINE COMPANY from GAS COMPANY.

2. GAS PARTNERSHIP owned a gas gathering system. GAS COMPANY had owned the gas gathering system prior to the formation of GAS PARTNERSHIP. PARTNERSHIP desired to purchase the gas gathering system. Ownership could be acquired either through the purchase of GAS COMPANY or the purchase of the gas gathering system from GAS COMPANY. In negotiating to purchase either GAS COMPANY or the underlying asset, PARTNERSHIP had several business concerns. First, there was a pending lawsuit that resulted in a million dollar judgment against GAS COMPANY that PARTNERSHIP did not want as a liability if the corporation were purchased; second, there were contracts that GAS COMPANY held for easements and right-of-ways for the pipeline that were essential to operating a gas

gathering system, and which were non-assignable and would cause problems in an asset purchase; third, there were income tax considerations in PARTNERSHIP , a partnership owning the corporation, GAS COMPANY.

GAS COMPANY, being aware of PARTNERSHIP'S various considerations, formed GAS PARTNERSHIP, which basically resolved the concerns. PARTNERSHIP could acquire the gas gathering system by purchasing the partnership interest and avoid an asset purchase or stock purchase, neither of which were desirable.

3. PARTNERSHIP purchased the 99% partnership interest from GAS COMPANY and the stock of PIPELINE COMPANY, as a second aspect of the purchase. In the Asset Purchase Agreement entered into by GAS COMPANY and PARTNERSHIP for the sale and purchase of the partnership interest, the stock of PIPELINE COMPANY was listed as an asset of the seller, GAS COMPANY, and transferred to buyer, PARTNERSHIP, at the closing.

4. The basis of the proposed assessment was the transfer of the assets of the partnership to a new owner. The Division viewed the general partner as owning a proportionate share of the partnership assets. The tax was not assessed on the value of the partnership interest itself.

5. Following the proposed assessment and prior to a hearing on this matter, the Division espoused an alternate argument for upholding the transaction taxable. At the hearing, the Division's theory of taxation had evolved to that of looking to the substance of the transfer rather than the form in which it took place. The Division argued that the sale was that of a gas gathering system, not merely the sale of partnership interest.

ISSUE

Where a corporation forms a partnership with a wholly owned subsidiary and transfers tangible personal property to the partnership in which it owns a 99% interest, with the remaining 1% interest owned by its subsidiary, and immediately sells the 99% partnership interest plus all of the stock in the subsidiary to a buyer, is sales tax due on the value of the underlying tangible personal property, the ownership of which passes to the buyer under the asset purchase agreement?

CONCLUSIONS OF LAW

1. The Oklahoma Tax Commission has jurisdiction of this protest.

2. Sales tax is levied on the sale of tangible personal property. 68 O.S. §1354. A sale is defined as the transfer of title or possession of tangible personal property for a valuable consideration, regardless of the manner, method, instrumentality or device by which the transfer is accomplished. 68 O.S. §1352. The question presented herein is whether there has been a transfer of tangible personal property on which the sales tax may be imposed.

3. A partnership interest is intangible personal property and is not subject to sales tax on the sale of the partnership interest. See Perkins v. Oklahoma Tax Commission, 428 P.2d 328 (Okl. 1967). Also, Oklahoma statutory and case law support a conclusion that the gas gathering system, in the case at hand, is an asset of the partnership, which is held by the co-owners as tenants in partnership, 54 O.S. §225, and is not subject to separate disposition by individual partners. Roby v. Day, 635 P.2d 611 (Okl. 1981).

4. The Division, however, has argued that an analysis of the facts of this case support an assessment for sales tax. The substance of this transaction, according to the Division, is that through a simultaneous transfer of the 99% partnership interest of GAS COMPANY and the stock sale of PIPELINE COMPANY, the entire gas gathering business was effectively transferred to the Protestant.

Substance over form is a doctrine that is well-recognized in matters of taxation. In Frank Lyon Co. v. U.S., 435 U.S. 561, 98 S.Ct. 1291, 55 L.Ed.2d 550 (1978), the United States Supreme Court explained this doctrine as follows:

> In applying this doctrine of substance over form, the Court has looked to the objective economic realities of a transaction rather than to the particular form the parties employed. The Court has never regarded "the simple expedient of drawing up papers," Commissioner of Internal Revenue v. Tower, 327 U.S. 280, 291, 66 S.Ct. 532, 538, 90 L.Ed. 670 (1946), as controlling for tax purposes when the objective economic realities are to the contrary. "In the field of taxation, administrators of the laws and the courts are concerned with substance and realities, and formal written documents are not rigidly binding." Helvering v. Lazarus & Co., 308 U.S., at 255, 60 S.Ct., at 210. See also Commissioner of Internal Revenue v. P.G. Lake, Inc., 356 U.S. 260, 266-267, 78 S.Ct. 691 2 L.Ed.2d 743 (1958); Commissioner of Internal Revenue v. Court Holding Co., 324 U.S. 331, 334, 65 S.Ct. 707, 89 L.Ed. 981 (1945). Nor is the parties' desire to achieve a particular tax result necessarily relevant. Commissioner of Internal Revenue v. Duberstein, 363 U.S. 278, 286, 80 S.Ct. 1190, 4 L.Ed.2d 1218 (1960).

435 U.S. at 573. While this doctrine has been generally utilized by the courts to look beyond the form of a "sham transaction" set up to avoid particular tax consequences, there is no suggestion by the Division or evidence in the record that the formation of the partnership in this case was for the purpose of avoiding sales taxes.

5. A federal court, however, focused on the substance of the transaction rather than the form in a case involving a partnership, but not a "sham transaction". In Holiday Village Shopping Center v. U.S., 773 F.2d 276 (Fed.Cir. 1985), a liquidating corporation, which had a 99% interest as a limited partner in a partnership, distributed all of its assets to its stockholders, including the partnership interest. The question involved which of two Internal Revenue Code provisions applied—one which involved non-recognition of gain on a corporate liquidation, which applied if the partnership was treated as an entity, the other was a recapture provision for

accelerated depreciation which applied if the partnership was treated as an aggregate of individuals—for income tax purposes. The claims court applied the specific provision treating the partnership "as a collection of individuals owning partnership property." Id. at 278. Holiday Village argued that the partnership was an "entity" and that the stockholders had transferred only the partnership interest and not the underlying partnership assets.

The appellate court framed its inquiry as whether it was more appropriate to treat the partnership as an aggregate or collection of individuals than as a separate entity. Holiday Village conceded that if it had owned the partnership property directly, the recapture provision would apply. Furthermore, there were only two partners and the 99% interest realistically gave Holiday Village an owner's interest as effectively as if it had owned the property directly. Id.. at 279-280. The court concluded that under those circumstances the partnership should not be viewed as an independent taxable entity wholly separate from and independent of its two partners and the court disregarded the partnership entity. Id. at 280.

6. The Division's characterization of the transaction is accurate. The economic reality of the transaction is that Protestant sought to purchase an asset, the gas gathering system, and through the various simultaneous transfers achieved 100% control of the gas gathering system. The form of the transaction was the sale of a partnership interest. The substance of the transaction should govern over the form under the specific circumstances of this protest.

7. The proposed assessment and protest herein present an issue of first impression in Oklahoma. There is an absence of any Oklahoma precedent on which to rely in deciding whether the proposed assessment should stand based on the substance of the transaction. The Division has cited a California State Board of Equalization ruling in support of the proposed assessment.

California's State Board of Equalization ruled that "a simultaneous transfer by all of the partners of their respective partnership interests for a consideration constitutes a sale within the meaning of Section 6006(a)." (That statutory provision defines "sale" as any transfer of title or possession, exchange or barter conditional or otherwise, in any manner or by any means whatsoever, of tangible personal property for a consideration.) In further support of the ruling the Board reasoned that "although in form the partners are making transfers of their respective 'interests' in the partnerships, the transfers are in fact transfers of specific partnership property to a third person." CCH State Tax Reporter (Cal.) ¶60-354, p. 6539.

Under the rationale of the California ruling, a sale of the gas gathering system has occurred. The transfer of the 99% partnership interest to the Protestant and the stock purchase of PIPELINE COMPANY was in reality the transfer of the ownership of the gas gathering system to Protestant. Thus, there has been a sale of the gas gathering system to Protestant on which sales tax is due. 68 O.S. §1354.

8. The protest should be denied.

DISPOSITION

It is the ORDER of the OKLAHOMA TAX COMMISSION, based upon the specific facts and circumstances of this case, that the sales tax protest of PROTESTANT d/b/a GAS COMPANY be denied.

OKLAHOMA TAX COMMISSION