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SALES TAXATION OF CAPITAL TRANSACTIONS IN MARYLAND

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A significant area of legal practice involves the planning and effectuation of capital transactions. These transactions include the formation and dissolution of partnerships, the formation, merger and liquidation of corporations, the sale of business assets and the sale of corporate stock. Although the income tax aspects of capital transactions are a predictable concern for both counselor and client, it is highly unlikely that either would give much thought to the effect of a retail sales tax. However, since the 1969 amendment[1] to the Maryland Retail Sales Tax Act,[2] as interpreted by a 1972 opinion of the Attorney General of Maryland,[3] this tax has become an item of concern to both the attorney and his client.[4] This amendment effectively removed the only provision by which most capital transactions were ordinarily exempted from sales taxation. That exemption, appearing in section 326(e) of the Act, previously excluded from taxation casual and isolated sales of otherwise taxable property, but now applies only to transactions for $1,000 or less. This poses a difficult and somewhat unique statutory and administrative situation. One direct consequence of this amendment is the newly created problem faced by each attorney as to whether or not this tax applies. Further ques-

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1. Ch. 424, [1969] Md. Laws 1060-61.
2. MD. ANN. CODE art. 81, §§ 324-71 (Supp. 1972). This legislation will hereinafter be referred to as the Act.
3. The Daily Record (Baltimore), Apr. 8, 1972, at 4, col. 2. The opinion is issued over the signatures of Attorney General Burch and Assistant Attorney General Rubin, and is directed to Henry A. Heinmuller, Jr., the Director of the Retail Sales Tax Division of the Comptroller's Office. The opinion was issued in response to questions raised by Mr. Heinmuller on the application of the sales tax to several transactions involving the transfer of all of the assets of a going business.
4. The problems reviewed in this article are highlighted in *Report of the Section of Taxation of the Maryland State Bar Association,* 5 MD. B. J. 18 (Jan. 1973).

tions arise as to what arguments can be made against its levy and whether or not a transaction can be designed to avoid it.

For those who assumed that a retail sales tax by its very terms could never apply to capital transactions[5] this may seem to be a peculiar and unnecessary analysis. It is unquestionable, however, that retail sales taxes have always applied to a number of transactions which are neither commonly understood as sales nor usually considered as having been made at retail.

Such taxes are regularly applied to non-consumer transactions. As long ago as 1938 it was noted that the imposition of a sales tax on non-consumer sales resulted in "an objectionable 'double' or multiple taxation of goods as an object of consumers' expenditures," and that very few of the state sales taxes then in effect contained language which prevented the imposition of a double tax.[6] In fact, many defined "retail sales" in such a manner as to tax many transactions which were not sales by retailers to

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5. There are a number of types of sales taxes, including retail sales taxes, general sales taxes, gross receipts taxes and gross income taxes. Since the Maryland statute deals with retail sales taxes, only that type of tax will be considered in this article. Retail sales taxes have been described as "pre-eminently taxes on margins" and "normally based upon retail sales of tangible personal property and the furnishing of certain services to consumers." N. JACOBY, RETAIL SALES TAXATION 7, 12 (1938) [hereinafter cited as JACOBY]. The retail sales tax has been described as a "uniform tax on consumer expenditures" and it has been noted that in Maryland and seventeen other states, the retail sales tax is "basically a consumer levy, imposed upon the retail sale." J. DUE, STATE AND LOCAL SALES TAXATION 24-25 (1971) [hereinafter cited as DUE].

The emergence of the retail sales tax as a means for raising revenue by the states can be directly attributed to the depression of the 1930's. As of mid-1932, general sales taxes were in effect in only six states, and in only two were they significant sources of revenue. By the close of 1937, general sale taxes were in effect in twenty-seven states, New York City and the District of Columbia. JACOBY at 71. As of 1971, forty-five states had adopted a sales tax, and the retail sales tax is the most significant source of state tax revenue today. DUE at 1.

It is interesting to note that sales taxes are not a twentieth century concept. Sales taxes were extensively applied in the kingdoms of the ancient world and in medieval Europe; perhaps the most famous of the historical examples is the tax known as the "Alcabala" employed by Spain subsequent to the thirteenth century and described by Adam Smith in WEALTH OF NATIONS. JACOBY at 12. Some of the earliest United States taxes which might be called sales taxes were the mercantile license taxes imposed in Pennsylvania, Virginia and Delaware as far back as the latter part of the eighteenth century. *See* DUE at 2.

The West Virginia gross sales tax, first effective in 1921, has been described as the first comprehensive and fiscally important sales tax in the United States. The first state to levy a retail sales tax at a substantial rate was Mississippi, which imposed such a tax in April, 1932. JACOBY at 61. *See also* R. HAIG and C. SHOUP, THE SALES TAX IN THE AMERICAN STATES (1934). This work, which at the time of its publication was the preeminent treatise on sales taxation, contains extensive surveys of the type of sales tax legislation then being adopted throughout the country.

6. JACOBY, *supra* note 5, at 127.

ultimate consumers.[7] There is no question that this situation continues to exist, perhaps even more so at the present time than in 1938.[8]

A collection of articles recently published by the Tax Institute of America includes a paper which discusses this aspect of sales taxation in the context of an analysis of neutrality in business taxation.[9] The author notes that the sales tax applies to many business purchases, estimating that fifteen percent to twenty-five percent of the average state's sales tax collections originate in the business sector. He comments:

> If we adopt the traditional textbook concept of the sales tax as a single-stage tax on consumption, then it is a mistake—a departure from neutrality—to include any business purchases in the tax base. To do so is to add a second layer of tax on those goods that require taxed inputs for their production. This viewpoint leads to the conclusion that all business purchases—raw materials, physical ingredients, machinery and equipment, office supplies, and so on—should be exempt.
>
> But there is another conception of the sales tax that seems to me to conform more closely to the actual practice of sales tax states. This conceives the sales tax as a single-stage tax on all private purchases of final products. Viewed this way the sales tax, to be neutral, should be levied on business purchases of final products the same as on consumer purchases. Only nonfinal products would escape. In this form, the sales tax seems . . . to resemble closely the value-added tax of the 'gross product' type—in common with the value-added tax it would tax all final products uniformly, thereby scoring high on neutrality.[10]

Assuming then that the Act can tax capital transactions in Maryland, let us consider some of the consequences. Suppose your client, A, decides to expand his artificial paper flower business, Flower Products. He wants to take in a partner, B, who will also bring to the endeavor materials, equipment and the neces-

7. *Id.*

8. This is made abundantly clear by the most comprehensive recent survey of state sales taxation, which appears in SPECIAL SUB-COMMITTEE ON STATE TAXATION OF INTERSTATE COMMERCE OF THE COMMITTEE ON THE JUDICIARY, SALES AND USE TAXES, H.R. REP. No. 565, 89th Cong., 1st Sess. (1965). Pages 743-46 are of particular relevance to this point.

9. F. Stocker, *State and Local Taxation of Business: An Economist's Viewpoint,* in BUSINESS TAXES IN STATE AND LOCAL GOVERNMENTS 37, 43 (1972).

10. *Id.* at 43.

sary expertise for the production of plastic artificial flowers. If A and B form a new partnership to which they transfer all of their business assets in exchange for equal partnership interests under present Maryland law, a sales tax might possibly be due. The transfer of manufacturing equipment and office furniture will be considered as a taxable sale if its value exceeds $1,000.

To go one step further, perhaps A and B soon thereafter wish to incorporate as Flower, Inc. While this could readily be done in an income-tax-free manner, the transfer of furniture and equipment in exchange for stock might be subject to the sales tax. In the event that Flower, Inc. grew and prospered, and was subsequently acquired by a conglomerate, General Gardens Corp., the sales tax might again be a factor to consider. On a merger into General Gardens or one of its subsidiaries, or on a sale of assets, a sales tax might be due which Flower, Inc. would be required to collect. Taking a dimmer view of its future, the liquidation of Flower, Inc. could also generate a taxable sale, as could its dissolution as a partnership.

It should be apparent that in a substantial capital transaction, the sales tax can be a very significant item which would add a considerable sum to the cost of the transaction. Where outside parties are involved, for example in a merger or acquisition, failure to give proper consideration to sales tax liability might well jeopardize the business combination. On the other hand, where a proprietorship becomes a partnership, or a partnership a corporation, failure to recognize sales tax liability could lead to problems with clients, if they are later audited and assessed the tax and penalties.

THE MARYLAND RETAIL SALES TAX ACT

At this point, an analysis of the Act is in order. The Act[11] was originally adopted in 1947,[12] and its basic taxing provision appears in section 325, which states that "[f]or the privilege of selling certain tangible personal property at retail as defined above . . . a vendor shall collect from the purchaser a tax at the rate specified in this section on the price of each separate retail

11. All subsequent references are to sections of the Maryland Retail Sales Tax Act as codified in article 81.

12. Md. Retail Sales Tax Act Ch. 281, [1947] Md. Laws 430. For a very brief period of time (1935-36) an Emergency Gross Receipts Tax was in effect in Maryland pusuant to ch. 188, [1935] Md. Laws 405, and appeared as a subtitle to article 56, "Licenses", of the Maryland Annotated Code.

sale made in this State. . . ."[13] The definitions of the terms used in the Act appear in section 324; the cross-referencing contained in these definitions, however, makes any analysis somewhat circular.[14]

The exemptions appear in section 326, and the exemption for casual and isolated sales is contained in section 326(e), which provides:

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13. MD. ANN. CODE art. 81, § 325 (1969).

14. The following definitional subsections of section 324 are relevant:

(b) '*Vendor*' means any person selling property or rendering services upon the sale of which a tax is imposed under § 325 of this subtitle.

(c) '*Purchaser*' means any person who purchases tangible personal property or to whom services are rendered, which are taxable under § 325 of this subtitle.

(d) '*Sale*' and '*selling*' mean any transaction whereby title or possession, or both, of tangible personal property is or is to be transferred by any means whatsoever for a consideration including rental, lease or license to use, or royalty, by a vendor to a purchaser. . . . Such consideration may be either in the form of a price in money, rights or property or by exchange or barter, and may be payable immediately, in the future, or by installments. . . .

(e) '*Tangible personal property*' means corporeal personal property of any nature.

(f) '*Retail sale*' and '*sale at retail*' shall mean the sale in any quantity or quantities of any tangible personal property or service taxable under the terms of this subtitle. Said term shall mean all sales of tangible personal property to any person for any purpose other than those in which the purpose of the purchaser is (i) to resell the property so transferred in the form in which the same is, or is to be received by him, (ii) to destroy the property so transferred in the manufacturing, assembling, processing or refining of other tangible personal property to be produced for sale or in the generation of electricity, or (iii) to use or incorporate the property so transferred as a material or part, or [sic] other tangible personal property to be produced for sale by manufacturing, assembling, processing or refining . . . . For the purpose of the tax imposed by this subtitle, the term 'sale at retail' shall include but shall not be limited to the following:

. . . .

(6) Sales of tangible personal property and/or services to any person who will use the same as facilities, tools, tooling, machinery or equipment (including, but not limited to dies, molds, and patterns) even though such person intends to transfer and/or does transfer title to such property or service either before or after such person uses the facilities, tools, tooling, machinery, or equipment.

. . . .

(i) '*Price*' means the aggregate value in money of any thing or things paid or delivered, or promised to be paid or delivered by a purchaser to a vendor in the consummation and complete performance of a retail sale without any deduction therefrom on account of the cost of materials used, labor or service cost, or any other expense whatsoever. . . .

(j) '*Business*' means 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.

(k) '*Engaging in business*' means commencing, conducting, or continuing in business, as well as liquidating a business when the liquidator thereof holds himself out to the public as conducting such a business.

> The tax hereby levied shall not apply to the following sales:
>
> (e) *Casual sale.* Casual and isolated sales by a vendor who is not regularly engaged in the business of selling tangible personal property provided, however, that this exemption shall not apply to casual sales for amounts of $1,000 or more, and/or which are made through an auctioneer or other regular dealer.[15]

The tax must be separately stated and charged at the time of sale, and it must be paid by the purchaser to the vendor as trustee for the state.[16] The vendor is liable for the collection of the tax, and any officer of a corporate vendor is personally liable for its collection.[17] Section 331(a) requires the purchaser to pay the tax directly to the Comptroller if the vendor fails to collect it.[18] Failure to file a return or pay the tax creates liability for a ten-percent penalty and interest of one-half of one percent per month or fraction thereof until payment.[19] Where any attempt to defraud has occurred, a one-hundred percent penalty can be imposed,[20] and wilful failure to collect or pay the tax, or its wilful evasion, can subject any taxpayer or officer of a corporate taxpayer to a fine of not more than $1,000 or imprisonment for not more than one year, or both.[21]

Returning briefly to the example discussed above, we can now point to the statutory provision which would exempt a transfer of inventory or raw materials such as paper, wire, paste or raw

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15. MD. ANN. CODE art. 81, § 326(e) (1969).

16. MD. ANN. CODE art. 81, § 327 (1969) provides:

> Upon each taxable sale or service the tax to be collected . . . . shall be paid by the purchaser to the vendor as trustee for and on account of the State, and the vendor shall be liable for the collection thereof for and on account of the State.

17. MD. ANN. CODE art. 81, § 328 (1969) provides in pertinent part:

> The vendor and any officer of any corporate vendor shall be personally liable for the tax collected or required to be collected under this subtitle . . . . Any vendor who fails to collect the tax, and any officer of a corporate vendor which fails to collect the tax . . . shall, in addition to all other penalties, be personally liable to the State for the amount uncollected.

18. MD. ANN. CODE art. 81, § 331(a) (1969) states:

> Where a purchaser has failed to pay or a vendor has failed to collect a tax . . . then . . . such tax shall be payable by the purchaser directly to the Comptroller, and the purchaser shall file a return thereof with the Comptroller and pay the tax imposed . . . . When any corporate vendee fails to pay the tax . . . then in addition to the liability of such corporate vendee, the officers, or any of them, of such corporation shall be personally liable. . . .

19. MD. ANN. CODE art. 81, § 344(a) (1969).

20. MD. ANN. CODE art. 81, § 344(b) (1969).

21. MD. ANN. CODE art. 81, § 369 (1969).

plastic from A and B to their new partnership, and from there to a corporation.[22] Unfortunately, no exemption is now available for the equipment used to manufacture the flowers, the office supplies and the furnishings, nor for other items of personal property which are used in the business but not held for resale or consumed in the production process, to the extent they exceed $1,000 in value.

Furthermore, the definitions of "sale," "retail sale" and "price" leave little doubt on their face that transfers of personal property in exchange for corporate stock or a partnership interest might be included under the Act. Similarly, transfers by merger, liquidation or dissolution can also fall within its terms. The only applicable exception is the casual sale exemption, which is set forth above.

Thus, if A and B have $200,000 of flower-making machinery and $50,000 of office equipment and supplies, sales taxes of $6,000 would appear to be payable upon the transfer thereof to a newly formed partnership or corporation. Merger into General Gardens Corp. would create an equal liability for General, and a liquidating distribution of these assets could leave A and B with the same tax liability. It is clear that none of this would have been true in the ordinary course of business in Maryland prior to 1969. The need for the Bar to consider these possibilities is only slowly becoming apparent. The serious economic consequences, though, make it mandatory that practitioners become familiar with the Act as well as its regulatory and judicial embellishments.

THE 1969 AMENDMENT

The amendment to the casual sale exemption,[23] which is the impetus for this discussion, was enacted by the General Assembly in its 1969 Session, effective July 1, 1969. Prior to the amendment, this section exempted:

> Casual and isolated sales by a vendor who is not regularly engaged in the business of selling tangible personal property and the use of an auctioneer shall not make a sale taxable which otherwise is not taxable under this sub-section.[24]

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22. MD. ANN. CODE art. 81,§ 324(f) (1969).

23. MD. ANN. CODE art. 81, § 326(e) (1969).

24. Ch. 55, [1958] Md. Laws 196. The amending legislation was introduced by Senators Meyer Emanuel of Price George's County and Charles Smelser of Carroll County, as Senate Bill No. 226. The amendment resulted from the work of the Special Joint Legislative Council Executive Committee on the Maryland Sales, Use, and Admissions

The amending legislation provided that the casual and isolated sale exemption was limited to sales amounting to $1,000 or less. This amendment resulted from the work of a Special Joint Legislative Council Executive Committee on the Maryland Sales, Use, and Admissions Taxes, which submitted a report of the results to the Governor and Legislative Council.

The report of the Committee is not particularly clear as to the purpose for the enactment of this amendment. In a list headed "Summary of Conclusions and Recommendations," item eighteen reads as follows:

> Casual sales are exempt under Maryland's law only because of the fact that the tax would be difficult or, in some cases, impossible to collect. On the other hand this exemption represents inequitable treatment of taxpayers and increases the possibility of tax evasion. The Committee recommends that all such sales made through auctioneers be taxed and that all casual sales over $1,000 be subject to the tax *if otherwise taxable.*[25]

Following this apparent conclusion is a reference to a section entitled "Sales by Certain Vendors or to Certain Purchasers".[26] The opening sentences and item two of this portion of the Committee Report read as follows:

> Certain organizations have been granted exemptions under the Maryland Sales Tax law when they are vendors and/or when they are purchasers. These exemptions are listed below with the Committee's action on each:
>
> . . .
>
> 2. *Casual and Isolated Sales by a vendor who is not regularly engaged in the business of selling tangible personal property.* Specifically stated is 'the use of an auctioneer shall

Taxes (hereinafter referred to as the Committee), which was chaired by Senator Emanuel, and on which Senator Smelser served. The Committee was created pursuant to House Joint Resolution No. 66 of the General Assembly of 1968, directing the appointment of such a committee to conduct an in-depth study of these taxes. The report of the Committee was submitted to the Governor and the Legislative Council on November 27, 1968 and is reprinted in MARYLAND LEGISLATIVE COUNCIL REPORT TO GENERAL ASSEMBLY 1968-69 Part 2 499-545 [hereinafter referred to LEGISLATIVE COUNCIL REPORT]. The legislation which was ultimately introduced as Senate Bill No. 226 appears as Exhibit I to the Committee's report, at page 542 of the LEGISLATIVE COUNCIL REPORT. This bill was later enacted on May 2, 1969. *See* Ch. 424, [1969] Md. Laws 1060-61.

25. LEGISLATIVE COUNCIL REP. *supra* note 24, at 503 (emphasis added).

26. LEGISLATIVE COUNCIL REP. *supra* note 24, at 515.

> not make a sale taxable which otherwise is not taxable under this subsection.'
>
> The exemption of such sale appears to have some justification, for the collection of the tax on many casual sales might be difficult to administer or enforce. On the other hand, testimony presented to the Committee suggests that considerable revenue is being lost through failure to impose the tax upon sales of items such as mobile homes. Imposition of the tax upon casual sales of this item alone could possibly produce as much as $100,000 in added revenue. It was suggested that it would be more feasible to administer the tax on casual sales if applied to large items.
>
> *The Committee accordingly recommends that the casual sale exemption provision in the Code be amended to remove (1) all sales made through auctioneers or other regular dealers and (2) all sales over $1,000.*[27]

It should be noted that there appears nowhere in this discussion the reference to taxation of sales only if they are "otherwise taxable", which is the language used in the summary quoted above.

In the letter of transmittal accompanying the Committee's report,[28] its chairman, Senator Emanuel stated that "[a] point to make abundantly clear to all readers is that this report basically was not intended to, nor does it make recommendation for any increase in the taxes we have studied. Without a clearly demonstrable need for additional revenues at this time, we feel that no such recommendation would be appropriate." Rather, Senator Emanuel pointed to the Joint Resolution creating the Committee, which sought an investigation of the equity, economic effects, compliance, and administration of the taxes with which the Committee was concerned. Vigorous imposition of the sales tax pursuant to the Attorney General's Opinion,[29] as it interprets the recent amendment, would quite probably generate substantial revenues, and one might argue that there would have been some mention of this aspect of the proposed amendment in the Committee report, if the Committee had intended to tax such transactions. Unfortunately, the legislative history is extraordinarily scanty and, in fact, consists entirely of the materials quoted herein. There is not sufficient basis to support any positive conclusions, and the language of the statute in question is so

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27. *Id.*
28. LEGISLATIVE COUNCIL REP. *supra* note 24, at 501.
29. The Daily Record (Baltimore), Apr. 8, 1972, at 4, col. 2.

clear that it is difficult to believe any court would turn to the legislative history.

While it is probable that the members of the Committee who considered this issue were concerned with the imposition of tax on the casual sale of substantial items of personal property, such as mobile homes sold on an irreguar basis by individuals, they accomplished this by the adoption of legislation which is far broader in scope than would have been necessary to reach the desired result.

JUDICIAL INTERPRETATIONS

Exemptions from sales taxation for what have been termed "casual and isolated sales" may be created by legislative enactment—either through a definitional exemption or a specific exemption, by judicial interpretation of the taxing statute or by administrative rulings. In the past, the Maryland courts have held that capital transactions are exempt only because of the casual and isolated sale exemption.[30] To furnish a complete picture of the manner in which the Maryland Court of Appeals will probably treat the exemption as amended, it is necessary to review the past construction by the court of both the exemption, as stated prior to 1969, and the Act as a whole.

The Act has been viewed as an all-encompassing taxing measure which is applicable to all transactions within its scope, with the exception of those qualifying under specifically delineated exemptions or those which fall outside the Act by virtue of a definition of terms. It has accordingly been very strictly applied. Two decisions by the Maryland Court of Appeals are of particular interest in this analysis since they emphasize the statutory scheme of the Act and the manner in which it has been interpreted. These cases are *Central Credit v. Comptroller*,[31] and *Comptroller v. American Cyanamid Co.*,[32] both of which concern the scope of exemptions from the retail sales tax.

In *Central Credit*, the appellant credit union argued that it was exempt from the tax under a statutory exemption since it was a non-profit organization, even though it conceded that it was not

30. *See, e.g.*, Comptroller v. Thompson Trailer Corp., 209 Md. 490, 121 A.2d 850 (1956); Comptroller v. Kaiser Aluminum & Chem. Corp., 223 Md. 384, 164 A.2d 886 (1960). *See also* notes 44-50 *infra* and accompanying text.

31. 243 Md. 175, 220 A.2d 568 (1966).

32. 240 Md. 491, 214 A.2d 596 (1965).

a religious, charitable or educational organization.[33] The court, upholding the Comptroller in refusing an exemption, found that the exemption for sales to non-profit organizations was limited strictly to sales to the organizations specifically identified in the statute. The opinion states:

> Section 333 [of the Act] expressly provides that it shall be presumed that all sales of tangible and personal property and services set forth in the subtitle are subject to tax until the contrary is established. Section 326 entitled 'Exemptions' states that the tax shall not apply to certain sales.
>
> . . .
>
> As Judge Markell said, for the Court, in *Comptroller of Treasury v. Crofton Co.*, 198 Md. 398, 404, 94 A.2d 86 (1951): 'We must apply the familiar rules that an exemption from taxation must be strictly construed and to doubt is to deny the exemption.'[34]

This decision makes it clear that all transactions involving sales as defined in the Act are subject to tax, in the absence of a *specific* exemption explicitly covering the transaction in question.

The *American Cyanamid* case involves a more complicated set of facts, dealing with an exemption arising from the definitions of the Act rather than from the statutory exemptions themselves. The appellee was a manufacturer of adhesives, and it sought to have excluded from retail sales taxation aluminum purchased for, and rendered completely unuseable by, the testing of batches of adhesives. The appellee relied on the theory that the aluminum was "consumed" in the process of the manufacturing operation and was therefore non-taxable pursuant to the definition of retail sale in section 324(f)[35] as interpreted by rule 63 of the Comptroller.[36] This definition excludes the transfer of property for use or incorporation as a material or part of other tangible

33. MD. ANN. CODE art. 81, § 326(i) (1969) provides that the tax does not apply to "sales to any person operating a nonprofit religious, charitable, or educational institution or organization . . . when such tangible personal property is purchased for use in carrying on the work of such institution or organization . . . ."

34. 243 Md. at 178-79, 220 A 2d. at 570-71.

35. MD. ANN. CODE art. 81, § 324(f) (1969) provides, *inter alia*, that the term "retail sale" does not include property purchased to be destroyed in manufacturing, assembling, processing or refining. The section then states: "Tangible personal property shall be considered to be destroyed in manufacturing, processing, assembling, refining or in the generation of electricity if it is changed in nature by reason of its use in a relatively short period of time . . . ."

36. COMPTROLLER OF THE TREASURY, TAX LAWS AND REGULATIONS, *Maryland Retail Sales and Use Tax Acts with Rules and Regulations*, rule 63, at 65,013.

personal property to be produced for sale by manufacturing. Rule 63 stated that property *consumed* in manufacturing operations was included within this provision. The court, however, found that this rule was an extension of the statute, and held that consumption was not the same as use or incorporation.

Throughout the opinion it was emphasized that where the language of the statute is clear and plain, there is no room for any interpretation, either administrative or judicial. Where there was "no ambiguity or uncertainty in the statute," there was "no need to look beyond its words to find its meaning."[37] The court cited the language of *Stembler & Ford, Inc.* v. *Capitol Heights*,[38] in which the court said of a taxing statute, "[I]f the language is plain and free from ambiguity and has a definite and sensible meaning, such is *conclusively* presumed to be the meaning of the legislative body in enacting the statute or ordinance.[39]

While Judge Barnes filed a very lengthy dissent, arguing that there was ambiguity in the statute and that the rule was a proper interpretation, he further reiterated the Maryland Court of Appeals' approach to exemptions in tax statutes. Judge Barnes cited *Suburban Propane Gas Corp. v. Tawes*,[40] quoting as follows:

> Of course, tax exemption statutes are to be strictly construed in favor of the State. The taxing power is never presumed to be surrendered. Every assertion that it has been relinquished must, to be effective, be distinctly supported by clear and unambiguous legislative enactment. To doubt an exemption is to deny it.[41]

Thus, any argument not directed toward the specific wording of the statute would appear to be fruitless. A strict interpretation of the taxing statute will be applied and the tax will be imposed on any capital transaction falling within its terms which does not meet the dollar limitation.[42] Any attempt to expand the language of that section through litigation will probably fail, given the

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37. 240 Md. at 505, 214 A.2d at 604.
38. 221 Md. 113, 156 A.2d 430 (1959).
39. *Id.* at 117, 156 A.2d at 432.
40. 205 Md. 83, 106 A.2d 119 (1954).
41. 240 Md. at 517, 214 A.2d. at 611.
42. Other cases interpreting the language and scope of the Act give slight comfort in the face of those decisions construing its exemptive provisions. *See, e.g.*, Frank J. Klein v. Comptroller, 233 Md. 490, 197 A.2d 243 (1964) (the Act is "a true sales tax"); Comptroller v. Fairchild Engine & Airplane Corp., 227 Md. 252, 176 A.2d 210 (1961); Comptroller v. Aerial Products, Inc., 210 Md. 627, 124 A.2d 805 (1956) (purpose of Act is to impose tax on "final purchaser or ultimate consumer", avoiding a pyramiding effect).

attitude of the Court of Appeals; the language is quite clear, and it would undoubtedly be construed narrowly to mean just what it appears to say. Similarly, any attempt to secure an exemption through other means—as through a construction of the definitional provisions of section 324—could also fail for the same reasons.

Any belief that the Maryland Court of Appeals would not apply the sales tax to capital transactions on "policy" grounds is cast in doubt by its only four decisions which specifically deal with such transactions. The first and possibly most important is *Comptroller v. Thompson Trailer Corp.*[43] In that case the appellee Thompson had purchased all of the machinery, equipment and real estate owned by a partnership known as Maryland Engineering Company in Pikesville, Maryland, in 1951. The purchase price was $250,000 for all of the tangible assets of Engineering, with the exception of raw materials, work in progress and finished products. Engineering had been in the woodworking business, producing cabinets and doors. Thompson was in the business of manufacturing trailer and truck bodies. On the purchase, Thompson assigned a value of $50,000 to the personal property. The Comptroller assessed a deficiency for sales tax with respect to the purchase of personal property, Thompson appealed to the Circuit Court for Baltimore County and the assessments were cancelled. The Court of Appeals affirmed that order.

Thompson argued that the transaction was covered by the casual and isolated sale exemption and also came within the terms of Comptroller's rule 39, which at that time provided that a sale of fixtures and equipment in conjunction with a complete liquidation of a business was to be considered a casual and isolated sale.[44] The court, in an opinion by Judge Hammond, noted

43. 209 Md. 490, 121 A.2d 850 (1956).

44. Pursuant to section 365(a) of the Act, the Comptroller is authorized to make "such rules and regulations as he shall deem necessary to carry out the provisions of this subtitle and to define any terms used herein." In accordance with this authorization, the Comptroller has adopted a number of rules which appear in a pamphlet produced regularly by the Retail Sales Tax Division of the Comptroller's office.

The particular rule which deals with casual and isolated sales is rule 39. In the most recent edition of the Sales Tax Pamphlet, issued as of June 1, 1972, this rule is as follows:

CASUAL AND ISOLATED SALES

There are two elements to the exemption for casual and isolated sales: (1) the sale must "be casual and isolated" [sic] and (2) the vendor must not be regularly engaged in the business of selling tangible personal property. However, this exemption does not apply to any sales for an amount of $1,000 or more and also does not apply to any sale made by or through an auctioneer or other regular dealer, whether for an undisclosed principal or disclosed principal. A sale shall be considered to be

for $1,000 or more if the total sales price on all sales made on the same occasion or as part of the same transaction by the same vendor to the same purchaser aggregate $1,000 or more, without regard to the value of the sale price of separate items.

Sales made by an officer of a court pursuant to an order of court are considered to be casual and isolated provided that they otherwise qualify under this exemption, i.e., the sale is less than $1,000 and is not made by or through an auctioneer or other regular dealer.

At the conclusion of the rule is the notation, "Effective July 2, 1970."

Prior to the enactment of the 1969 amendment to section 326(e), rule 39 was significantly different from the 1971 version. The Sales Tax Pamphlet which was issued as of July 1, 1968, contains rule 39 in the following form:

CASUAL AND ISOLATED SALES

The tax does not apply to casual and isolated sales made by a vendor who is not engaged in the business of selling tangible personal property. However, the tax does apply to sales made by those persons who hold themselves out as engaged in business notwithstanding the fact that their sales may be few and infrequent.

Any property which has been used in or connected with the business of the vendor is subject to the tax. Where a person sells his household furniture, he makes a casual or isolated sale, since the furniture was never used in or connected with his business.

All sales made by officers of a court, pursuant to court orders, are casual and isolated sales, except sales made in connection with the liquidation or the conduct of a regular established place of business. Examples of such casual sales are those made by sheriff's in foreclosure proceedings and sale of confiscated property.

Manufacturers, processors, refiners and miners in the business of producing and wholesalers engaged in distributing tangible personal property who sell primarily other than retail, are not deemed to be making casual or isolated sales, when they sell such tangible personalproperty to purchasers for use or consumption, notwithstanding that sales at retail may comprise a small fraction of their total sales.

Sales in bulk of fixtures and equipment in conjunction with the complete liquidation of a person's business provided that by such liquidation the person, as a legal entity, shall divest himself entirely of the business of selling tangible personal property, are considered casual and isolated sales.

Sales by contractors of their equipment are not deemed to be casual or isolated sales and they must collect the tax thereon unless such sales take place in conjunction with a complete liquidation of the contractor's entire business.

While it probably has no legal significance, it is interesting to note that the first issue of the Sales Tax Pamphlet following the enactment of the 1969 amendment does not contain rule 39 in the same form as it appears in the 1971 pamphlet. The Sales Tax Pamphlet dated June 1, 1969 contains the following version of rule 39, which falls somewhere between the two versions just set forth:

CASUAL AND ISOLATED SALES

The tax does not apply to casual and isolated sales. A sale will be deemed to be casual and isolated and not taxable if: the sale is made by a person not regularly engaged in the business of selling, leasing or renting tangible personal property of any kind and the sale totals less than $1,000; or the sales are made by an officer of a court pursuant to an order of court; or the sale is a sale in bulk of fixtures, equipment and stock and [sic] trade in conjunction with the complete liquidation of a business in which the seller, as a legal entity, divests himself entirely of the business of selling tangible personal property.

A sale made by or through an auctioneer, whether for undisclosed principal or disclosed principal, cannot qualify as a casual and isolated exempt sale.

This 1969 version of rule 39 appears to continue the casual and isolated sale exemption for the sale of the business even though it also reflects the $1,000 limitation imposed by

that by a fair reading of the words "engaging in business", one cannot normally be considered to be engaging in business when he is liquidating, unless, if while liquidating, he represents to the public that he is still engaging in business. The court found that in this case Maryland Engineering Company did not hold itself out to the public as doing anything other than liquidating its business, since it was "merely selling its stock on hand and com-

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the newly enacted amendment to section 326(e). Most likely, this was merely an oversight by the staff of the Retail Sales Tax Division responsible for production of the pamphlet, although it might be interpreted as some evidence that the purpose of the amendment was not to tax the sale of a business.

There are no other regulations which bear on the treatment of capital transactions. The omission from the current version of rule 39 of any reference to the sale or liquidation of a business does not necessarily mean that transactions of that type are taxable; however, the recent opinion has of course taken that position, and the omission of the exemption for such capital transactions from this rule certainly can be interpreted as further evidence of the administrative position that such transactions are no longer exempt.

A recent case which involved the construction of another rule promulgated by the Comptroller under the sales tax has re-emphasized the authority of the Comptroller to construe the statute within reasonable limits. In F. & M. Schaefer Brewing Co. v. Comptroller, 255 Md. 211, 257 A.2d 416 (1969), the appellant challenged Comptroller's rule 24 requiring a purchaser of electricity first to obtain an exemption certificate in order to qualify for the statutory exclusion from sales taxation of such purchases. The Court of Appeals held that this particular rule was an invalid attempt to render taxable purchases which were specifically defined as not taxable, in that the rule required a resale certificate when the statute clearly exempted such transactions *per se*, without any additional requirements.

The opinion sets forth what, for our purposes, are the interpretive limitations which must be faced in any challenge to a rule promulgated pursuant to section 365(a) of article 81. The opinion states, at 218-19:

> [T]he construction placed upon a statute by administrative officials soon after its enactmentment is strong, persuasive influence in determining the judicial construction and should not be disregarded except for the strongest and most urgent reasons, ... In *Comptroller v. American Cyanamid Co., supra* [240 Md. 491, 214 A.2d 596 (1965)], however, the comment is made:
>
> 'There can be no challenge to the proposition that the Comptroller cannot by rule or otherwise make taxable that which the Legislature has excluded or exempted from taxation and cannot exclude or exempt that which the law says is taxable' *Id.* at 505.

This language might lend support to an argument based on rule 39 as it appeared in the 1969 edition of the Sales Tax Pamphlet, since that was the first statement issued after the adoption of the amendment in question. As noted, however, the change in the rule which became effective in 1970 would most likely be the interpretation by which any court would feel bound, and it does not appear that the principal of statutory construction just stated above would be applied against the interests of the state. Further, the rule on its face merely reflects the clear language of the statute and is not in conflict with it. In *Thompson Trailer*, however, a factual problem was presented because the partners of Engineering, following the sale of its woodworking business, sold stock on hand, completed a contract for cabinets and continued to operate a metal business in Randallstown for a short period of time in order to satisfy a contractual obligation to the federal government. The Comptroller had found that the sale to Thompson did not amount to a complete dissolution of Engineering's business, because of the continuance of these activities.

pleting a contract."[45] This was not a sale in the ordinary course of business, but was exempt as casual and isolated, since it was a sale which was never to be repeated. The court then cited *Geneva Steel Co. v. State Tax Commission*,[46] a Utah case, which held that the sale of an integrated business was a casual and isolated sale within the meaning of the casual and isolated sales exemption to the Utah retail sales tax. The Maryland court in *Thompson Trailer* adopted the reasoning of the Utah court and found that on the record the sale which took place in *Thompson Trailer* was the kind of sale contemplated by the legislature as an exemption to the sales tax statute. This was a definitive judicial statement that the Maryland legislature intended the casual and isolated sale exemption to proscribe sales taxation of the liquidation of an integrated business and it seemed clear in Maryland that the "complete liquidation, never to be repeated" test was determinative. Thus, there would be no sales tax upon the sale of a corporate, partnership, or proprietorship business. Unfortunately, a subsequent case, *Comptroller v. Kaiser Aluminum & Chemical Corp.*,[47] seems to disagree sharply with the conclusion of the Utah court in *Geneva*. *Geneva* involved the sale of an integraed steel business by the War Assets Administration. The State Tax Commission contended that although the sale was that of an integrated business, the War Assets Administration was regularly engaged in the business of selling surplus government property and therefore the sale was not casual or isolated. The court, however, found the sale to be casual and isolated.

In *Kaiser*, a similar situation was involved, where Kaiser Aluminum purchased an aluminum extrusion plant from the G.S.A. The sale included machinery and equipment. The Comptroller argued that the G.S.A. was regularly engaged in the business of selling tangible personal property. Kaiser argued that the rule of *Thompson Trailer* should apply; it argued that the G.S.A. was in the position of a liquidator who, by not holding itself out to the public as conducting a business, was entitled to the exemption for casual and isolated sales by a vendor not regularly engaged in the business of selling tangible personal property.

The court conceded that the G.S.A. was never in the aluminum extrusion business or any other manufacturing business, and it also conceded that the activities of this agency in disposing of

45. 209 Md. at 501, 121 A.2d at 856.

46. *Id.* at 502, 121 A.2d at 857, citing 116 Utah 170, 209 P.2d 208 (1949).

47. 223 Md. 384, 164 A.2d 886 (1960).

surplus plants and equipment could not be described as doing "business" in the absence of a profit motive. The court read the Act, however, as requiring only the act of selling itself. The opinion states:

> Even in the case of sales outside the regular course of business, we think it is clear that the tax is collectible, unless it be shown that the particular transaction is casual and isolated. In the instant case it is clear that the sale in question is only one of a long series of operations to be continued into the indefinite future. The appellee would have us hold that because the sale in question was of a single, integrated plant, the transaction was casual and isolated. We cannot conceive that each in a series of unrelated transactions could fall in the exempt category as being isolated and nonrecurring.[48]

The Maryland Court of Appeals vigorously rejected the approach of the Utah court as is evident from the following statement in the *Kaiser* opinion:

> The ultimate thrust of the decision in . . . [*Geneva*] seems to be not upon whether the sale was casual or isolated, but upon whether the statute purported to tax any sale of a mixed lot of real and personal property for a lump sum. In short, the gravamen of the decision seems to be that the legislature could not have intended to tax complex transactions, because of the difficulty of allocating a portion of the price to the tangible personal property. We do not agree with that reasoning.
>
> In the instant case, we see no difficulty in making an allocation. Indeed, the appellee made an allocation upon its books . . . for income tax purposes.[49]

A dissent was filed by Chief Judge Brune who argued that the sale was casual as defined in the law since it could not properly be included in a series of sales of small articles of surplus property. He evidently agreed with the conclusion in *Geneva* that the sale of an entire plant was a unique and isolated transaction which was not meant to be taxed by a retail sales tax statute.

Due to the *Kaiser* opinion, it is evident that the Court of Appeals has decided to apply the sales tax to the sale of an entire business operation, at least to the extent that it includes the transfer of tangible personal property. This decision was reached

48. *Id.* at 389, 164 A.2d at 888-89.
49. *Id.* at 390, 164 A.2d at 889.

when the statutory exemption for casual sales was considerably broader than it now is. It can therefore be argued that the court would have no hesitancy to continue to apply the sales tax to such capital transactions. There would be no need for an inquiry as to whether the sale was one of a series, so long as the tangible personal property so transferred had a value of $1,000 or more. As noted above, the opinion in *Kaiser* appears to reject the conclusion reached in the *Thompson Trailer* case as to the intent of the legislature with regard to the imposition of sales tax on the capital transaction of a sale of a business. Surely, therefore, if the court believed the legislature could have meant to tax capital transactions under the Act as it existed prior to the 1969 amendment, they would not likely find, subsequent to that amendment, that the legislature no longer intended to tax such events.

In 1970 the decision of *ACF Industries, Inc. v. Comptroller*[50] effectively reaffirmed the holding in *Kaiser*. In this case the appellant was a diversified corporation engaged in manufacturing, electronics, research and other business activities. At some time prior to 1966, it had acquired an electronics laboratory in Prince George's County. This business was sold in 1966 to ITT in exchange for 21,000 shares of ITT stock; the laboratory was not separately incorporated. ACF was also the operator of a research company in Riverdale. This was run as another division of the business for approximately nine years, and it was sold to another purchaser in 1966 or 1967. A total sales tax of $15,000 was assessed with respect to the sale of the personal property involved in each of the sales of these businesses. ACF appealed to the Maryland Tax Court which affirmed liability for a sales tax on both transactions. In its opinion, the Tax Court found that in the preceding thirteen years, ACF had acquired and sold or otherwise disposed of five separate business activities, including these two. It also found that ACF had sold and was still selling tangible personal property in Maryland in the regular course of its business, particularly used and obsolete equipment and machinery, and that it had retained one other business activity aside from the five of which it had disposed. Emphasis was placed on the fact that neither of the two businesses sold subject to the sales tax had been separately incorporated. The Circuit Court of Prince George's County affirmed the decision of the Tax Court, and this decision was in turn affirmed by the Court of Appeals.

50. 257 Md. 513, 263 A.2d 574 (1970).

The appellant relied on the casual and isolated sale exemption as defined by the rule of *Thompson Trailer* and Comptroller's rule 39. It argued that the sales were not part of a planned series of transactions and were in fact casual and isolated, and that the exemption properly applied to sales of separate and idependent businesses of a taxpayer who remains in business after the sales. The Court of Appeals rejected this argument. It found that for a sale to be exempt as casual and isolated, it had to be made by a vendor not regularly engaged in the business of selling tangible personal property, as well as being casual and isolated. Since it was conceded that ACF was still selling tangible personal property in Maryland in the regular course of its business, an essential requisite for qualification as an exempt vendor under the casual sale exemption was lacking. The court distinguished *Thompson Trailer*, on the basis of the fact that the vendors in that case were selling their entire business and plant to retire from business. There had been no repeated pattern of sales of separate business activities along with sales of other tangible personal property on a regular basis, such as had been demonstrated by ACF.

Maryland Glass Corp. v. Comptroller,[51] a 1958 case, also interpreted the rule of *Thompson Trailer*, applying a futher limitation to its "complete liquidation, never to be repeated" test. Between 1949 and 1954 Maryland Glass had purchased a number of pieces of machinery for manufacturing glassware from a Connecticut supplier. The Comptroller assessed use taxes of approximately $12,000 on these purchases, and after payment under protest a claim for refund was filed with the Baltimore City Court.[52] The claim was denied, but the Court of Appeals reversed on the ground that the property in question was not readily obtainable in Maryland, an exemption under the use tax statute in force at that time.[53]

51. 217 Md. 241, 142 A.2d 570 (1958).

52. The use tax is a tax imposed by MD. ANN. CODE art. 81, § 373 (1969). The use tax only applies to those transactions which would be subject to a sales tax but for the fact that the sale did not take place in Maryland. Therefore, any transaction which would be exempt from the sales tax is also exempt from the use tax. Comptroller v. American Cyanamid Co., 240 Md. 491, 214 A.2d 596 (1965); Comptroller v. Fairchild Engine & Airplane Corp., 227 Md. 252, 176 A.2d 210 (1961); Comptroller v. Glenn R. Martin Co., 216 Md. 235, 140 A.2d 288 (1958).

53. The exemption in question exempted from taxation "[t]angible personal property not readily obtainable in Maryland . . . used . . . in this State by a person engaged in . . . manufacturing . . . if such tangible personal property enters into the processing of . . . the product . . . which is manufactured . . . ." Ch. 681, § 310(f) [1947] Md. Laws 1673 (repealed 1955).

The Court of Appeals affirmed the lower court on another issue raised by Maryland Glass, that of whether or not the sale was casual or isolated and thereby exempt from the use tax.[54] The lower court held that the sales in question were not casual or isolated. In this case, the seller had been required to offer the equipment for sale by virtue of an order in an antitrust case against it. The seller had previously leased the machinery to Maryland Glass and had also licensed its use under a number of patents. Pursuant to the antitrust order, the property was transferred at its book value in the hands of the seller, in exchange for a price determined by a formula contained in the antitrust order reflecting prior lease and royalty payments. The court's rationale for denying the exemption and affirming the lower court was that Maryland Glass not only acquired title to the equipment, but also a "bundle of rights" making up complete title to the machinery without any requirement for the payment of subsequent royalties or patent fees. In this sense, the purchase of the equipment was somewhat akin to the purchase of equipment in a business acquisition, since Maryland Glass acquired more than just the nuts and bolts of the machinery. The corporation thus attempted to argue the rule of *Thompson Trailer* on a theory that the equipment sales here were in effect pursuant to a liquidation of the previous leasing business of the seller. The case is significant because the Court of Appeals once again reiterated that *Thompson Trailer* dealt with the complete liquidation of the only business of the seller, which was never to be repeated. The opinion also emphasized that there was no separate sale of the patent rights to the machinery, and that the transactions fell within the definition of "price" in the statute.[55] There seems to be an implication that a separate sale of the patent rights would not have been subject to the use tax, but the facts did not support such separate treatment.

Subject to the difficulty of reconciling *Thompson Trailer* with *Kaiser* as to legislative intent, it was presumably the intention of the legislature at least prior to the enactment of the 1969 amendment to exempt from tax the sale of personal property transferred as a component part of the sale of an integrated busi-

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54. As noted earlier, all exemptions which apply to the sales tax are also applicable to the use tax. This is specifically provided at the present time in MD. ANN. CODE art. 81, § 375(b) (1969) which in enumerating specific exemptions states: "(b) *When exempt from retail sales tax.*—Tangible personal property expressly exempted from the retail sales tax imposed by this State under the terms and provisions of § 326 of this article."

55. MD. ANN. CODE art. 81, § 324(i) (1969).

ness. That may still be the intent of the legislature, to the extent that they were not conscious of the effect of the 1969 amendment. That amendment's language is, however, so clear that it renders pointless any attempt to look at the intent behind it. It could also be argued that the passage of that amendment is an indication of a different intent on the part of the legislature.

Summarizing the effect of these four cases on sales taxation of capital transactions, it is clear that the courts of Maryland have not been hesitant to apply the tax to the sale of businesses. Prior to the 1969 amendment, it was reasonably clear that the sale of a business in the course of which the seller completely terminated its business activities was not subject to the tax by virtue of the casual and isolated sale exemption. On the other hand, if the seller sold a series of businesses, it was subject to the tax with respect to the tangible personal property transferred in each sale. As to other capital transactions—mergers, reorganizations, corporate and partnership formations—there is no statement of past or present judicial policy, and presumably, this is still an open question. It must be recognized, however, that the few cases discussed here clearly indicate a propensity on the part of the Comptroller and the courts to tax these events.

THE 1972 OPINION

With the background of the Act itself and the judicial interpretations reviewed above, we should briefly consider the opinion of the Attorney General of Maryland[56] which, in effect, announced the intentions of the Retail Sales Tax Division to impose the sales tax on capital transactions.

After a brief review of certain definitional sections of the Act, the opinion states:

> The general rule of these sections is that all transfers of title or possession, or both, of tangible personal property not otherwise exempted or excluded, made for a consideration, are subject to the tax. That the imposition of the tax is not normally dependent upon the nature of the Seller's business or whether the sale is made in the regular course of business is well established.[57]

The opinion then examines the statutory exemption for casual and isolated sales prior to the enactment of the 1969 amendment,

56. The Daily Record (Baltimore), Apr. 8, 1972, at 4, col. 2.
57. *Id.*

particularly as it had been construed in the *Thompson Trailer*, *ACF*, and *Kaiser* cases. The opinion concludes as to the prior practice:

> It is our opinion that these cases establish that a sale of an entire business cannot be considered exempt as casual and isolated where either the vendor continues to remain regularly engaged in any other business activities in which he sells tangible personal property, or where the sale is one of several in a series of similar transactions or is otherwise a planned or expectable part of the vendor's operations.[58]

The opinion then discusses the 1969 amendment and its interpretation in an earlier opinion.[59] It notes that this amendment has the effect of making the exemption inapplicable as to sales in conjunction with the liquidation of a business for an amount of $1,000 or more, and that in determining whether the $1,000 limit had been met in the sale of an entire business only the amount paid for the tangible personal property is to be considered.[60]

Having disposed of the casual and isolated sale exemption, the author examines at some length the general statutory scheme of the Act. He notes that the Act contains no exclusion for sales of an entire business apart from the casual sale exemption, and if that exemption does not apply, the general provisions of the Act are applicable to determine if any part of the transaction is subject to the retail sales tax.[61]

The opinion does, at least, recognize that a number of elements involved in the sale of an entire business would not be taxable under the statute. These include: intangible property such as good will or receivables; real property or other assets not classifiable as tangible personal property; property which is excluded from taxation by virtue of the definition of "retail sale" in the Act, such as stock in trade held for resale, raw materials to be used as a material or part of other tangible personal property to be produced for sale by manufacturing, or fuel consumed in manufacturing or processing; and any property or transaction within the terms of any of the remaining statutory exemptions,

58. *Id.* at col. 2-3.

59. 55 OP. MD. ATT'Y GEN. 384 (1970).

60. *Id.*

61. In a footnote, there is a citation to the conclusion in *Kaiser*, which rejected the holding of *Geneva Steel*, that the legislative intent was not to tax capital transactions, at least with regard to the sale of a business.

such as sales of motor vehicles upon which the titling tax has been levied. The requirements that property be transferred for a consideration and that the tax be computed on the basis of the price of the retail sale are briefly dealt with, essentially leaving it to the administrative authorities to determine the existence of consideration and the amount of the price.

At this point the opinion finally comes to the heart of the question at hand—the sales taxation of capital transactions. It states:

> The general rule of the sales tax is that it is applicable to all sales of tangible personal property made in this State other than those specifically exempted or excluded. We find nothing which would alter this rule in the case of transfers of an entire business, bulk sales, or other transactions out of the ordinary course of business, other than the exemption for casual and isolated sales, which is extremely limited in its application, and which must be strictly construed against the taxpayers.[62]

The opinion then applies this conclusion to three examples of capital transactions.

The first example considered is that of the liquidation of a subsidiary corporation by merger into its parent corporation. The opinion finds that such a transaction would not be subject to imposition of the sales tax, since it is not made for a consideration, or if there is a consideration, it is valueless. The conclusion rests on the fact that the transfer of the corporate property is made by operation of law pursuant to Maryland corporate law, and that following such transfer by operation of law, the stock of the subsidiary previously held by the parent is without any value. There is no physical transfer of the stock certificates, and no other consideration is paid to the transferee of the property. This is consistent with the approach taken in earlier opinions reviewed below concerning liquidating dividends and distributions in liquidation to shareholders of a dissolving corporation.

Having reached this conclusion, however, the opinion makes what could be a financially disastrous leap for Maryland taxpayers involved in capital transactions. It states:

> However, as to other transfers under Article 23, [the Maryland corporate law] made pursuant to Articles of consolidation . . ., Articles of merger . . . or Articles of sale,

62. The Daily Record (Baltimore), Apr. 8, 1972, at 4, col. 3 (footnote omitted).

> lease, exchange or transfer . . . a transfer of assets could and in all probability would be made in return for an ascertainable consideration, either in money, stock or some other form. In such transactions, we believe that the sales tax would normally be applicable and must be calculated on the basis of the actual consideration given in return for the transfer of the property in question.[63]

The second example concerns the creation of a new corporation by an existing Maryland corporation. The existing corporation will transfer all of the operating assets of its business to the new corporation and receive in return all of its capital stock. The old corporation will continue in existence as a holding company of which the new corporation will be a wholly-owned subsidiary. The opinion finds that this is not a transfer such as the previously described merger in liquidation, in that it is not made pursuant to any provision under the Maryland corporate law which accomplishes a transfer of title by operation of law. The stock which is transferred to the parent corporation in exchange for the assets must, according to the opinion, be viewed as "property" which can constitute "consideration" for purposes of the Act. In support, the opinion cites the decision in *ACF* and earlier opinions of the Attorney General with respect to transfers of real estate and motor vehicles to newly formed corporations, where such transfers were held to be subject to taxation under the recordation tax, and the motor vehicle titling tax, respectively. The opinion concludes:

> Since there appears to be no question that the transfer of assets to an existing corporation in return for shares of its stock is a taxable transaction under the Retail Sales Tax Act if the casual and isolated sales exemption is inapplicable, as in the *ACF* case, because the vendor continues to remain engaged in the business of selling tangible personal property, or as discussed above, because the sale is for an amount of $1,000.00 or more, we can find no basis for distinguishing the instant transaction, merely because the purchaser is a newly-formed corporation, rather than an existing corporation. In either case, there is a transfer of title and possession of tangible personal property, between separate legal entities, made for consideration. Having found that all of the elements necessary to constitute a 'sale' are present and,

63. *Id.* at col. 4.

assuming, that some part of the property transferred is not purchased for resale (e.g., the manufacturing equipment, office supplies, etc.), it is our opinion that the transaction would be a 'retail sale' subject to the tax.[64]

As a final comment on this second example, the author somewhat facetiously notes that if the value of the property transferred is less than $1,000, the transaction may still be exempt within the very limited casual sale provision now in the Act.[65]

The third and final example appearing in the opinion concerns the incorporation of a sole proprietorship or a partnership, upon which all of the assets of the former business are transferred to a new corporation in return for its stock. It again concludes that all of the elements of a "sale" under the Act are met, namely, a transfer of title and possession of tangible personal property between separate entities made for a consideration. The opinion again refers to the previous opinions on the application of recordation and title tax to the transfer of property on the incorporation of a new entity. While the author concedes that the legislature may not have intended to subject this type of transaction to the retail sales tax, he finds no exclusion or exemption which can be applied to exempt such an incorporation.

Attention is quite properly directed to a recent amendment to the Maryland motor vehicle law which provided in very specific terms an exemption for incorporation in very specific terms from the excise tax on motor vehicles.[66] Since this taxing statute is essentially identical in format to the sales tax statute, the analogy is very tellingly made in the opinion. Thus, the opinion

64. *Id.* at col. 5. On the question of the amount of the "price" paid, the opinion suggests reference to the market price of the corporate stock transferred in exchange for the property, as of the day of the transaction in question. Recognizing that in its own example no readily ascertainable market value can be determined, the opinion concludes in this situation that the value of the stock and the amount of the price paid "must be considered to be presumptively equal to the fair market value of the property transferred." *Id.*

65. This miniscule benefit is immediately diminished by subsequent language which states that even if the sale involved such a small amount of property, it may still fail the test of *Thompson Trailer*, if it is part of a continuing series of transactions and if the seller remains in business following the sale.

66. MD. ANN. CODE art. 66½, § 3-831(a) (Supp. 1972). This section imposes an excise tax on the issuance of original and subsequent certificates of title for motor vehicles in Maryland. The amendment added an exception to the imposition of this tax, which reads as follows: ". . . motor vehicles transferred from an individual to a partnership or corporation upon formation of the partnership or corporation, when the individual is a partner in the newly formed partnership or a principal stockholder in the newly formed corporation. . . ." *Id.*

concludes that incorporation transactions are taxable retail sales, subject to sales tax unless the very limited casual sale exemption applies.

A principal source of interpretative material on which the March 10, 1972 opinion relies consists of earlier opinions of the Attorney General determining the applicability of various Maryland taxes to capital transactions. The majority of these opinions deal with the recordation tax; however, there are two relevant opinions in other areas, one of which concerns the titling tax imposed on the transfer of motor vehicles and the other an interpretation of the 1969 amendment to the casual sale exemption under the sales tax. None of these opinions, with the sole exception of the one relating to the sales tax, have any direct persuasive authority; however, they present evidence of administrative and legislative treatment of capital transactions in related areas which arguably requires similar treatment under the sales tax.[67]

The opinions which deal with the recordation tax have drawn distinctions between taxable and non-taxable transactions on the basis of the vesting of title. If the determination is made that the transaction in question merely vests record title in the holder of equitable title, no tax will be due. For example, no tax was payable when the sole shareholder of a dissolved corporation received a deed conveying all of its real estate.[68] Similarly, no tax was due when a subsidiary transferred all of its assets to its parent as a liquidating dividend,[69] nor when two corporations merged and one

67. This is a most difficult argument to make in view of the comprehensive and relatively self-contained nature of the Act, and its total lack of interrelationship with the recordation or motor vehicle titling taxes.

68. 24 OP. MD. ATT'Y GEN. 973 (1939). This opinion stated that "[t]he stockholder, although without legal title, has a very definite interest in the corporate property and upon dissolution and payment of the corporate debts the stockholder becomes vested with an equitable title to the real estate. The deed to him is only for the purpose of vesting in him the legal title to what is, in substance, already his property." *Id.* It concludes that there was no "consideration paid or to be paid" by the stockholder with respect to the property which was transferred to him, and therefore, no recordation tax is payable.

69. 22 OP. MD. ATT'Y GEN. 808 (1937). This opinion seemed to assume that no tax was payable upon the transfer by a subsidiary corporation of all of its assets to its parent as a liquidating dividend. This was clarified by then Deputy Attorney General Hall Hammond in a later opinion, 32 OP. MD. ATT'Y GEN. 394 (1947), which considered the application of the recordation tax to a deed conveying real estate from a subsidiary to a parent in connection with the dissolution of the subsidiary and the distribution of all of its assets to the parent. In this opinion, it was held that if the execution of the deed was one of a series of steps in a bona fide and final dissolution, no recordation tax was payable, on the same theory that the deed merely vests record title in the holder of equitable title. The opinion goes on to state, however, that the tax would be due if there was only "an indefinite intention of dissolving" the subsidiary. He also indicates that the clerk to whom

executed a deed conveying real estate to the other.[70] On the other hand, if the transaction is viewed as one which passes more than mere legal title, the sales tax will be found applicable. For example, the assessment of tax was made where real estate was transferred to a corporation in exchange for stock,[71] and where personal property was transferred by a corporation under a second mortgage, although the property had already been transferred to the same mortgagor by a first mortgage from a related corporation.[72]

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the opinion is directed should be satisfied that no consideration passed between the parties, implying that the distribution of property with respect to the stock held by the parent did not constitute consideration for purposes of the recordation tax.

70. 43 OP. MD. ATT'Y GEN. 332 (1958). Here two corporations merged, one of them executing a deed conveying real estate to the surviving corporation. The opinion cites the appropriate section of the Maryland corporate law which provides that, upon a consolidation or merger in accordance with that law, all of the property of the corporations party to the merger vests in the surviving corporation. The opinion then concludes that in the case of a corporate merger, a change in title takes effect automatically upon compliance with the merger provisions of the corporate law. The deed to the surviving corporation only transfers legal title to what is already its property, and therefore, no recordation tax is payable. Cited as supporting authority are a number of opinions which state that no tax is payable where there is no actual consideration paid or to be paid. While it is not clear what the author of the opinion understood to be the payment of any consideration upon the merger in question, it is hard to believe that he knowingly took the position that no consideration is paid in a corporate merger.

A later opinion, 47 OP. MD. ATT'Y GEN. 196 (1962), reaffirms this treatment of the recordation of an instrument merely confirming a transfer of real property effected through the statutory provisions of the Maryland corporate law. This opinion concerns the transfer of all of the property and assets of Bowie Race Track by Articles of Sale. While a very substantial consideration was paid, the opinion makes it clear that the deed in question was merely confirmatory and did not "convey title" to the transferee, which is the basis for application of the recordation tax.

71. 32 OP. MD. ATT'Y GEN. 394 (1947). In this case, two individuals conveyed their fee simple interest in real estate to a Maryland corporation which they apparently formed, in exchange for stock of the corporation. The "net cost" to the individuals of the real estate was somehow fixed, and they received corporate stock in an amount equal in value to that figure in exchange for the property. The opinion states:

> It is a well established principle that a corporation is a distinct legal entity, separate and apart from its stockholders. Thus, where a corporation takes fee simple title to real estate under a general warranty deed, it holds the property in its own name and right and not in trust for the stockholders. This would be true in ordinary circumstances even though there were only a single stockholder. Moreover, where the corporation pays for the real estate by issuing shares of its stock, the transferor has received actual and valuable consideration for his grant.

Id. at 395. It concludes that the transaction is properly taxable, but that the proper measure of consideration is the current value of the transferred property, not necessarily the "net cost" to the individuals.

The 1939 opinion was distinguished on the basis that facts in this case involved more than the mere vesting of technical legal title in the persons already holding equitable title. It appears to be questionable whether this is a valid distinction, for in each instance, the shareholders are merely exchanging one type of interest for another, and in both instances the legal title to the property in question is transferred. Therefore, if the tax is applicable

There are no other opinions concerning the recordation tax; however, in another Attorney General's opinion, the motor vehicle titling tax was held applicable to the transfer of title to certain property from a partnership to a newly formed corporation in exchange for stock.[73]

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to transfers upon formation of a corporation, it should be equally applicable to transfers in dissolution of that corporation. *See also* 42 OP. MD. ATT'Y GEN. 372 (1957), where the seller had transferred real property to a corporation in exchange for shares of its capital stock, and as part of the transaction the corporation assumed a mortgage on the property. The value of the stock was equal to the value of the real estate, less the amount of the assumed mortgage. The opinion found that the recordation tax should be calculated on the value of the stock plus the amount of the mortgage assumed, thus implicitly considering the corporate stock to be consideration paid for purposes of the recordation tax. Once again, it is somewhat difficult to integrate this interpretation of the status of corporate stock with the treatment given to that stock upon its cancellation and liquidation in the opinions dealing with dissolutions.

72. 49 OP. MD. ATT'Y GEN. 461 (1964), which involved a Maryland corporation which executed a chattel mortgage as security for a substantial loan. Thereafter, another corporation, the stock of which was owned by substantially the same persons owning the stock of the first corporation, executed a chattel mortgage to the same mortgagee with respect to the same personal property. The second mortgagee claimed an exemption from any recordation tax on the recording of the new chattel mortgage, but the ruling denied the exemption. The opinion states: "[W]e can only view the extrinsic identification of the property mortgaged, the amount of debt secured and the stockholders of the two debtor corporations as neutral circumstances. Regardless what kind of corporate reorganization underlay the rearrangement to which the stated facts bear witness, it is apparent that whatever is sought to be accomplished under the new mortgage [is not affected by the original mortgage]." *Id.* at 462.

73. 32 OP. MD. ATT'Y GEN. 285 (1947). The question here was whether the transfer of title of various buses to a newly formed charter and school bus corporation by members of the partnership which formerly conducted the business constituted a sale within the meaning of the section of the motor vehicle law imposing a titling tax upon the transfer of title to motor vehicles. The partners in question had transferred all of the property of the partnership to the corporation in exchange for an equal number of shares of stock.

The opinion considers the definition of "sale" in various cases, treatises, the Uniform Sales Act and also in its general statutory use. It then reached the following conclusion:

> Revenue statutes are to receive a reasonable construction with a view to carrying out their purposes and intent, . . . and we think the net result of the authorities which we have cited is that the transaction about which you inquire is a sale within the meaning and intent. . . [of the statute in question], and that upon the issuance of titles for the motor vehicles the 2% excise tax based upon their fair market value must be collected. It cannot be said that the transfer of the motor vehicles was not a sale within the meaning of that term, ... The issuance of capital stock to the individuals comprising the partnership certainly furnished the valuable consideration for the transfer and if the term 'sales or resales' as used in the Act was to be understood and applied as meaning something which altered the *Lockerman* case, the General Assembly, we must presume, would have furnished us with its own definition.
>
> We are unable to conclude that the Legislature, without furnishing some other statutory standard by which a sale was to be defined, intended to repudiate the definition adopted by the Court of Appeals.

Id., at 288. The case referred to is Eastern Shore Trust Co. v. Lockerman, 148 Md. 628,

The opinion concerning the casual sale exemption under the amended section 326(e)[74] relates to sales by a trustee in bankruptcy which exceed $1,000 or which are made by an auctioneer, and states:

> . . . It is our opinion that the 1969 amendment removes any exemption which section 326 previously provided for sales made by a trustee in bankruptcy in conjunction with the liquidation of a bankrupt's estate where the sale is for an amount of $1,000 or more, or is made through an auctioneer.
>
> . . . .
>
> Under this provision as it existed before the 1969 amendment sales made by a trustee in bankruptcy in conjunction with a liquidation would have been considered exempt if they fell within the doctrine first enunciated in [*Thompson Trailer*] and further developed in [*Kaiser* and *ACF*], ...
>
> The 1969 amendment substantially changes the preexisting law relating to casual and isolated sales. We have no difficulty in determining the clear mandate of the amendment to mean that any sale which is for an amount of $1,000 or more. . . .[75]

This opinion has had a direct influence on the interpretation of the applicability of the sales tax to capital transactions. The conclusion which was reached clearly presages the 1972 opinion in its assertion that the 1969 amendment substantially changed the law and was intended to limit the casual sale exemption only to sales of less than $1,000. Nevertheless, the recordation tax opinions dealing with liquidation distributions should be persuasive in the sales tax area, for if no consideration is deemed to have been paid for the purposes of one tax, it is seemingly inequitable to assert its existence for purposes of another tax. It is hard to imagine a dissolution situation involving merely corporate stock in which consideration was "paid" for tangible personal property but not for real property. In a contrary fashion, however, the recordation tax opinions dealing with corporate formation

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129 A. 915 (1925), where it was held that, "[t]o sell means ordinarily to transfer to another for a valuable consideration the title or the right to possess property." *Id.* at 636, 129 A. at 919.

74. 55 OP. MD. ATT'Y GEN. 384 (1970).

75. *Id.* at 384-86.

lend further support to the conclusion that the sales tax is applicable to certain capital transactions.[76]

SOME INTERIM ARGUMENTS AND ALTERNATIVES

It is apparent that the present Maryland law as judicially and administratively interpreted does not provide much encouragement to the attorney or businessman confronted with a potentially taxable capital transaction. To the extent that title or possession to any tangible personal property is transferred for some form of consideration from one legal entity to another, such transactions will be held subject to the sales tax. The presumption raised by section 333 of the Act, that all sales of tangible personal property are subject to tax until the contrary is established, is a looming obstacle to an argument for exemption, now that there is no statutory exemption where more than $1,000 is involved.[77] The general scheme of the Act supports taxability and the general direction of sales taxation seems to be towards the imposition of a tax on any transfer to a final consumer. Transfers of tangible personal property in capital transactions fall within this last category, and from an economic point of view, there is little reason or logic for an exemption. An application of the tax would make the application of the sales tax more "neutral," presumably a desirable goal for all taxing statutes.

The most compelling reason for this conclusion is the explicitness of the 1969 amendment to the casual sale exemption. Although it is highly probable that the legislature did not intend to extend the Act to capital transactions, the law as enacted clearly removes the only exemption in the Act which might have ex-

76. One other opinion should be noted, although its holding is somewhat confusing. In 39 OP. MD. ATT'Y GEN. 219 (1954), liability for the motor vehicle excise tax was considered with respect to buses transferred in a statutory merger. The opinion states that the tax would not be due, in apparent reliance on the provision of Maryland corporate law transferring title to such assets upon a merger by operation of law. The tax is not imposed, though, on transfers, but rather on the issuance of certificates of title. MD. ANN. CODE art. 66½ § 3-831(a) (1969). Whether the transfer is by operation of law or otherwise, the tax on its face would seem to be payable any time a certificate is issued. One could view the issuance of the certificate as mere confirmation of the already vested title (like a confirmatory deed in the recordation opinions) and presumably reach the result of this opinion. That ignores, however, the different acts which trigger the imposition of these two taxes—recordation of documents conveying title, in the one case, and issuance of a certificate of title in the other.

77. MD. ANN. CODE art. 81, § 333 (1969) provides in pertinent part that "[i]t shall be presumed that all sales of tangible personal property . . . are subject to tax until the contrary is established, and the burden of proving that a sale is not taxable hereunder shall be upon the vendor or the purchaser as the case may be."

cluded such transactions from taxation. As previously discussed, prior to the 1969 amendment the Maryland Court of Appeals stated that there was no legislative intent to exclude capital transactions *per se* from the sales tax; therefore, there is little hope for the creation of a judicial exemption.[78] In addition, any argument as to intent would run head on into the explicit language of the statute, since it is a long standing rule of statutory construction that where the words are clear there will be no investigation into legislative intent.

In spite of the clear statutory language, attorneys will nevertheless be expected to develop arguments against imposition of the sales tax and to suggest alternative methods for structuring transactions so that the tax will not be due.

Returning to our hypothetical clients, A and B, let us consider what advice can be given. Where A and B have proposed to form a partnership,which is later to be incorporated, a strong argument can be made that there is no true "purchaser" within the definition of the Act. This would also be applicable to liquidations and dissolutions, for all four cases involve transactions in which no actual consideration in money or its equivalent is paid by a third party. There is no Maryland case in which a general definition of "purchaser" or a "purchase" is given. There are a number of cases, however, which seem to imply that a purchase takes place when there is a voluntary agreement whereby property passes hands for an actual consideration in money or its equivalent, as distinguished from an acquisition by operation of law.[79] Taking this approach, there is no purchaser in any capital transaction where there is no actual consideration paid. Since the

78. An example of the creation of a casual sale exemption formed through judicial action is found in Georgia's treatment of the sales tax. The Georgia statute, GA. CODE ANN. §§ 92-3402a-03a (1972) has no provision for an exemption for casual sales. The statute taxes every person engaged in the business of selling tangible personal property, and broadly defines "business" in the same manner as the Maryland statute. In Novah v. Redwine, 89 Ga. App. 755, 81 S.E. 2d 222 (Ct. App. 1954), the Georgia court determined that the legislature had no intention to tax a casual or isolated sale since the definition of the term "business" implied a continuity of transactions and not a single transaction. The court then concluded that a bulk sale was exempt as a casual or isolated transaction by a person not in business. *See also* Williams v. Sunannee Longleaf Mfg. Co., 97 Ga. App. 431, 103 S.E. 2d 123 (Ct. App. 1958); State v. Dyson, 89 Ga. App. 791, 81 S.E. 2d 217 (Ct. App. 1954). As a result of these court decisions, the state tax authorities adopted an administrative regulation providing for the casual sale exemption. GA. TAX. REGS. § 560-12-1-.07.

79. *See, e.g.*, Bowles v. Nelson-Ricks Creamery Co., 66 F. Supp. 885 (E.D. Idaho 1946); City of Enterprise v. Smith, 62 Kan. 815, 62 P. 324 (1900); Cobb v. Webb, 26 Tex. Civ. App. 467, 64 S.W. 792 (Civ. App. 1901).

tax is imposed on a vendor who is to collect it from "the purchaser," there can be no tax if there is no purchaser. This position is strengthened theoretically by the fact that in each case neither economic substance nor equitable ownership has changed.

A variation on this theme, and a particularly persuasive point in business formations, is the argument that there is no "sale" in these types of capital transactions. This is, perhaps, a somewhat more difficult position to maintain, since the definition of a sale[80] encompasses any transaction whereby title or possession, or both, of tangible personal property is or is to be transferred by any means whatsoever. With such a definition, it would appear that virtually every transaction in which any property is in fact transferred would be covered. Encouragement can be found, however, in the treatment of rental and leased property under the Act. The "title or possession" language included in the definition of "sale" has been in the Act since its adoption in 1947, but prior to June 1, 1955, the Retail Sales Tax Division acknowledged that the sales tax did not apply to rentals or leases of tangible personal property.[81] By an amendment to the Act effective on that date,[82] the words "including rental, lease or license to use, or royalty" were added to the "sale" definition in section 324(d). Thereafter, the tax was accordingly assessed.

The analogy to our concern lies in a lease or rental arrangement's facial satisfaction of the original definition of "sale." Clearly, possession of tangible personal property is transferred for a consideration in such a case. Title remains in the vendor, but transfer of title has never been required by section 324(d).[83] It would seem that the Comptroller did not assess the tax in the belief that, absent statutory explication, a rental or lease did not comport with the general understanding of a sale and the intent of the Act, even though it would have been covered by a literal reading of the law. Similarly, capital transactions which do not involve a change in economic or equitable substance should not

80. The term "sale" as defined in article 81 includes any "transaction whereby title or possession, or both, of tangible personal property is or is to be transferred by any means whatsoever. . . ." MD. ANN. CODE art. 81, § 324 (d) (1968).

81. COMPTROLLER OF THE TREASURY, TAX LAWS AND REGULATIONS, *Maryland Retail Sales and Use Tax Acts with Rules and Regulations*, rule 73, at 65,013, which states: "the tax must be collected and/or paid on all rentals for periods after May 31, 1955. . . ."

82. Ch. 332, §§ 1-5, [1955] Md. Laws 504-08.

83. For a discussion of this point see Comptroller v. Pittsburgh-Des Moines Steel Co., 231 Md. 132, 145-47, 189 A.2d 107, 114-15 (1963).

fall within the usual context of taxable retail sales and should not be taxable without further statutory amendment.[84]

A valid planning device derived from the foregoing analysis can be used in partnership formations or incorporations which might involve taxable transfers of substantial amounts of tangible personal property such as equipment and machinery. For example, the A-B partnership would receive 1,000 shares of common stock of Flower, Inc. upon payment of $1,000. That transaction would obviously not be covered by the sales tax. The balance of the business assets of the partnership would then be transferred to the new corporation, but no additional consideration (shares of stock) would be issued. Thus, the sales tax, while applicable, would be zero since it is measured by the "price" paid by the purchaser.[85] In this instance, the purchasing corporation has paid nothing, but has merely received a contribution to capital from its stockholders. Putting this into a partnership context, the documentation should substantiate that the partnership interest is acquired for a nominal price, followed by a contribution to the partnership by the partners without payment of additional consideration in the form of increased partnership interests. The same technique should be employed in any expansion of the partnership involving acquisition of taxable property, since this would legally constitute the termination of the previous entity and the formation of a new partnership.

Several other forms of capital transactions continue to be exempt from the sales tax, and the most advisable course of action would be to follow their formats to the extent possible. One, such example is the liquidation of a subsidiary into its parent corporation, pursuant to Maryland corporate law.[86] Another situation is a tax-free reorganization involving the exchange of corpo-

84. Where a corporate liquidation is involved, another argument can be based on the recordation tax opinion holding that the distributee in liquidation is merely receiving legal title to property already owned equitably. 30 OP. MD. ATT'Y GEN. 193 (1945). Reliance on the treatment of transactions under other taxing statutes is questionable, because of the self-contained nature of the Act and its relative lack of interrelationship with other taxes. These problems arise again in any attempt to argue unconstitutional discrimination in the application of the sales tax to transactions to which the recordation tax or motor vehicle titling tax are not applied. Such an argument might be made, for example, with respect to mergers under Maryland corporate law. The different schemes of the taxing statutes, however, seriously weaken the argument. Certainly, if the legislature wishes to apply one type of tax to a transaction which is exempted from another type of tax, that is its prerogative.

85. MD. ANN. CODE art. 81, §§ 325, 324 (i) (1969).

86. *See* note 62 *supra* and accompanying text.

rate stock under section 368(a)(1)(B) of the Internal Revenue Code,[87] or any other transaction which simply involved the transfer of shares of stock as opposed to the transfer of the underlying corporate assets. A triangular reorganization under section 368(a)(2)(E) of the Internal Revenue Code[88] also falls within this area. In this situation the surviving corporation would be the acquired corporation which originally owned the tangible personal property in question and the only transfer is that of the stock of the acquired corporation. For example, suppose that General Gardens Corporation formed Greater Flower, Inc., which then merged into Flower, Inc., whereupon A and B received General Gardens stock for the stock of their company. Flower, Inc. would thereafter be a wholly-owned subsidiary of General Gardens, and title to its property would not have changed. Even though this accomplishes through one form without the imposition of sales tax a transfer which might be subject to that tax in another form, a "substance over form" argument should not pierce the legal framework within which the transaction rests.[89] Under the terms of the Act itself, there is no way that this transaction can be construed to have transferred title or possession of any tangible personal property. It is clear from the 1972 opinion that form is a dominant consideration, and in this instance, form can be turned around on the taxing authorities to prevent the imposition of the sales tax.

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87. INT. REV. CODE OF 1954, § 368(a)(1)(B) defines one type of reorganization which is exempt from taxation under INT. REV. CODE OF 1954, § 354. The definition applies to the acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or part of the voting stock of a corporation which is in control of the acquiring corporation), of stock of another corporation if, immediately after the acquisition, the acquiring corporation has control of such other corporation (whether or not such acquiring corporation had control immediately before the acquisition).

88. INT. REV. CODE OF 1954, § 368(a)(2)(E) provides that a statutory merger or consolidation

> shall not be disqualified [from being a tax-free reorganization] by reason of the fact that stock of corporation . . . which before the merger was in control of the merged corporation is used in the transaction, if—
>
> (i) after the transaction, the corporation surviving the merger holds substantially all of its properties and of the properties of the merged corporation (other than stock of the controlling corporation distributed in the transaction); and
>
> (ii) in the transaction, former shareholders of the surviving corporation exchanged, for an amount of voting stock of the controlling corporation, an amount of stock in the surviving corporation which constitutes control of such corporation.

89. It has been suggested that California tax enforcers will take a "substance over form" approach where "step transactions" have been used to avoid sales tax in cases where it would otherwise apply to capital transactions. Gobar, *California Sales Tax Problems In Disposing of a Close Corporation*, 1967 SO. CAL. TAX INSTITUTE 91, 111-12.

There is also an argument to be made in the other principal type of triangular reorganization, under section 368(a)(2)(D) of the Internal Revenue Code, pursuant to which the acquired corporation is merged into a new corporate subsidiary.[90] Using our earlier example, Flower, Inc. would merge into the new company. Here, it is clear that both title and possession of tangible personal property have been transferred. The argument for non-taxability would rest on the fact that no consideration was paid by the entity which is in fact the legal purchaser. In such a transaction, the parent (General Gardens) of the legal purchaser (Greater Flower, Inc.) has paid the consideration, but that entity (General) has been the transferee of no property other than corporate stock. The actual transferee of the property, the new corporate subsidiary (Greater Flower, Inc.), paid nothing to the transferor (Flower, Inc.) either in stock or otherwise. Thus, the measure of the tax is zero, and no tax can be due. Once again, this involves heavy reliance on the legal form of the transaction and therefore the language of the statute must be strictly followed. Such an approach should be justifiable, given the highly technical manner in which the Act is now being applied.

A more standard type of capital transaction, a corporate statutory merger under section 368(a)(1)(A) of the Internal Revenue Code,[91] in which former stockholders of the merged corporation receive stock of the surviving company, is allegedly taxable under the 1972 opinion. Suppose Flower, Inc. merged into General Gardens Corp. directly, with A and B receiving General stock. The Retail Sales Tax Division would presumably argue that sales tax was collectible by them to the extent that taxable property was transferred to General. There are substantial weaknesses, however, in that position. First, A and B have "sold" their stock in Flower, Inc., if in fact they have sold anything. Second, title and possession of the taxable property was in their corporation, not in them, and that entity received no consideration for the trans-

90. INT. REV. CODE OF 1954, § 368(a) (2) (D) defines another type of reorganization which will be exempt from taxation under section 354. The definition states that:

> [t]he acquisition by one corporation, in exchange for stock of a corporation . . . which is in control of the acquiring corporation, of substantially all of the properties of another corporation which in the transaction is merged into the acquiring corporation shall not disqualify a transaction [as a tax-free reorganization] if (i) such transaction would have qualified . . . if the merger had been into the controlling corporation, and (ii) no stock of the acquiring corporation is used in the transaction.

91. INT. REV. CODE OF 1954, § 368(a) (1) (A) provides that the term "reorganization" includes "a statutory merger or consolidation."

fer, producing a zero tax payable by the true vendor. Finally, transfer of title is by operation of law, although the "sale" definition in section 324(d) of the Act may be so broad as to include such a transfer. Similar objections could be raised in certain instances involving articles of sale or of consolidation.

A final type of capital transaction is the sale of all of the assets of a business, and here, arguments against the levy of a sales tax or methods of avoiding it are not readily apparent. Such a sale by a corporation might be free of income tax under section 368(a)(1)(C) of the Internal Revenue Code,[92] but it is difficult to see why the sales tax would not apply with respect to the transfer of tangible personal property included in the group of assets, absent a broad casual sale exemption. Not only must one consider the *Kaiser* case and its predecessors, but also the fact that this is a transaction subjected to sales tax under similar statutes in other states.[93] One technique to reduce the tax due on such a

92. INT. REV. CODE OF 1954, § 368(a) (1) (C) defines another form of tax-free reorganization under section 354 as:

> [t]he acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of substantially all of the properties of another corporation, but in determining whether the exchange is solely for stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded.

93. Particular attention to this type of capital transaction is given by the authors of two articles which have considered the application of the California sales tax. The first is Sato, *The Sales Tax and Capital Transactions*, 45 CALIF. L. REV. 450 (1957) [hereinafter referred to as Sato]; the second is Gobar, *California Sales Tax Problems in Disposing of a Close Corporation*, 1967 SO. CAL. TAX INSTITUTE 91, a somewhat more limited discussion.

The Sato article was written as a consequence of two California cases on the sales taxation of the sale of an entire business, Sutter Packing Co. v. State Bd. of Equalization, 139 Cal. App. 2d 889, 294 P.2d 1083 (Dist. Ct. App. 1956); Market Street Ry. v. California State Bd. of Equalization, 137 Cal. App. 2d. 87, 290 P.2d 20 (Dist. Ct. App. 1955). Market Street was primarily engaged in operating a street railway in San Francisco, but it had made some 900 separate retail sales between 1933 and 1948. These were predominantly sales of obsolete equipment; however, one, in 1944, involved the sale of all of its operating property to San Francisco. After the sale to the city, Market Street ceased its business and made additional sales in liquidation of its remaining property. The receipts from the sale to the city were over $2,500,000, while the gross receipts from the other property sales were approximately $100,000. *See* Sato at 458.

In 1949, California assessed a deficiency against Market Street with respect to all of the sales, including the bulk sale of its operating assets. The article notes that the sale to the city was clearly a retail sale under the statute, and Market Street was equally clearly a retailer thereunder. Sato at 459. Market Street argued that the sales tax did not contemplate taxing the receipts from the sale of the business, but since the court could find no exemption in the statute for such a transaction, it held that Market Street was subject to the tax.

The article seems to interpret this decision as an extension of Bigsby v. Johnson, 18 Cal. 2d 860, 118 P.2d 289 (1941), which applied the tax to the sale by a printer of a piece

transfer could be an effort by the purchaser to minimize the consideration allocated to taxable property; this will be limited to some extent by income tax considerations encouraging substantial allocations to obtain a high depreciable basis in the newly purchased property.

A PERMANENT SOLUTION

There are other arguments which could be made and other methods of structuring transactions which could be developed to limit the application of the tax. For decades lawyers have been devising sophisticated techniques to minimize income taxes, and the economic effects of the sales tax may be sufficiently severe to warrant the same creative efforts. One must ask, though, whether or not such elaborate planning should be required when dealing with the retail sales tax. The obvious answer is that it should not.

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of used equipment incidental to his business, since the seller was in a retail business and there was no exemption for any kind of sale made by such a seller. That was decided prior to the incorporation of a casual sale exemption in the statute, as was the *Market Street* case.

The second of the California cases was, however, decided under the revised sales tax law which included this exemption. Sutter Packing was a fruit and vegetable processor and distributor. Between 1945 and 1949 it made several retail sales of used equipment and supplies on which a sales tax was paid. On one occasion it also sold all of its equipment for a substantial sum and paid the sales tax thereon. In 1949, it transferred inventory to an affiliated company and sold all of its remaining operating assets to an unaffiliated company for a very substantial price. During the months preceding this sale and termination of its business, it had also made approximately eleven other retail sales.

Sutter argued that it was not a retailer when the last sale was made and also that sales in liquidation were not taxable. The court disagreed, holding that it was still a retailer through the last sale, since negotiations for that sale had commenced immediately after its decision to discontinue business, and it was merely one in a series of sales made in liquidation. Consistently, the court found nothing in a sale in liquidation to distinguish it from any other taxable sale, when it was merely one of a series of taxable sales.

The *Sutter Packing* decision in some respects reflects the same line of reasoning which appears in *Kaiser* and *ACF*. Neither Maryland case cited this decision, and of course the Maryland statute did not include a "number, scope and character" test in the previously extant casual sale exemption. Nonetheless, the thrust of these decisions is, in effect, to include such a test in the old casual sale rule, at least when considering the application of the sales tax to the sale of an entire business.

Sato is considerably troubled by the poor draftsmanship of the California occasional sale exemption and the definite inequities which it caused. Sato, *supra*, at 462-67. He agrees nonetheless that, absent an amendment to the statute, the decision in *Sutter Packing* is probably a correct interpretation of that exemption. There has been no amendment since the time of that article which clearly exempts sales of a business. It has been noted, without any comment on the inherent inequity, that the sale of a business by a retailer (anyone required to hold a seller's permit) will trigger the application of the sales tax, even though a similar sale by one not required to hold such a permit would be free of that tax. *See* Gobar, *supra* at 92-93, 99. *See also* Evans v. Idaho State Tax Comm'n, CCH STATE TAX REP., IDAHO ¶ 15,494 (1973).

The statute should be amended to eliminate both the confusion and uncertainty as well as the need for schemes and avoidance techniques, however legitimate they may be.

One alternative would be to amend the casual sale exemption back to its original form, with the addition of a new provision to impose the sales tax on sales of mobile homes. The desire of the Retail Sales Tax Division to tax such sales seems to have been the basis for the original amendment of the casual sale exemption, and this suggestion would yield that result without creating a confused legal situation as to other transactions. This would also place the Maryland Sales Tax in conformity with the statutes of other states which impose a sales tax—a desirable result if we wish to encourage interstate commerce and the use of Maryland as a corporate legal home for national companies. All of the states which impose a sales tax apparently provide a meaningful exemption for most casual or occasional sales except Colorado, New York, Oklahoma and Wyoming.[94]

Despite this widespread adoption, no comprehensive discussion of the occasional and isolated sale exemption has been found. The existence of such an exemption is mentioned only in passing in the most recent legal treatise on this subject.[95] Due treats the exemption in less than a page, stating as follows:

> Sales made by persons other than regular vendors are defined as "casual", "isolated", or "occasional" sales. . . . Most states also exempt casual sales by business firms, that is, sales of equipment and other items not normally handled in the course of business. Such sales are taxed, however, in Arizona, Georgia (if the annual figure exceeds $500), Kentucky, Louisiana, Maryland (if the annual figure exceeds $1,000), Nevada, Oklahoma, Utah, Washington, Wisconsin, and the District [of Columbia], plus the three states taxing all casual sales [Colorado, New York and Oklahoma].
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> A number of states encounter difficulty with exemption of motor vehicles. . . .
>
> As noted, casual sales are usually defined to be sales by persons other than those offering the goods for sale in the ordinary course of business. Some variation exists in inter-

94. P-H STATE AND LOCAL TAX SERVICE SALES TAXES, ALL STATES ¶ 92,953 (1973) (hereinafter referred to as P-H SALES TAXES). Due, [*supra* note 5, at 79-80] claims the exemption is provided in some form by all of the states except Colorado and New York, although he concedes that Oklahoma's exception is limited.

95. J. HELLERSTEIN, STATE AND LOCAL TAXATION 486-87 (1969).

96. DUE, *supra* note 5, at 79-80.

> preting this rule, but the general idea is relatively standard: status as a vendor depends upon whether there are regular sales . . ., solicitation of regular business, maintenance of a place of business, and similar considerations.[96]

Given Due's misconstruction of the Maryland exemption, it is possible that his other legal conclusions are erroneous; however, his statement of the "general idea" is relatively accurate.[97]

Basically, the exemption is statutory, definitional, regulatory or administrative, or judicial. An example of the statutory exemption is found in the Maryland law.[98] Definitional exemptions arise through the definition of various terms in the sales tax statutes. For example, the Kansas law defines the term "business" to exclude the isolated or occasional sale of tangible personal property by a person not engaged in the business of making such sales.[99] An example of a regulatory or administrative exemption can be found in Alabama. That sales tax statute[100] provides no exemption for casual sales *per se* and imposes a tax on all "retailers" of tangible personal property. The definitions are such that casual and isolated sales could be included. The State Department of Revenue, however, has promulgated a sales tax rule which exempts casual and isolated sales by persons not in the business of selling.[101]

Finally, an example of the creation of a casual sale exemption by judicial action can be found in Georgia. As is the case in Alabama, the Georgia statute[102] provides no specific exemption

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97. *See* Des Moines & Central Iowa Ry v. State Tax Comm'n, 253 Iowa 994, 115 N.W. 2d 178 (1962), concerning the meaning of an occasional and isolated sale exemption. There the court found the Iowa sales tax rule exempting casual sales to be without statutory foundation and therefore invalid. The taxing statute which was in existence at that time imposed a two percent tax upon the gross receipts from all sales of tangible personal property. *See* ch. 196, § 2, [1937] Iowa Laws 410. There was no statutory casual sale exemption. While the statute [Ch. 196, § 1(f), [1937] Iowa Laws 410] did define gross receipts as the total amount of sales of retailers, the court adopted an interpretation which made the tax applicable to all sales of tangible personal property. *See also* Note, *Taxation: Application of Sales Tax To Occasional and Isolated Sales*, 12 DRAKE L. REV. 81 (1962). At the present time, the Iowa law does provide a statutory exemption for the gross receipts from casual sales. IOWA CODE ANN. § 422.43 (1971).

98. MD. ANN. CODE art. 81, § 326(e) (1969). For other examples see CAL. REV. & TAX CODE § 6367 (1970); D.C. CODE ANN. §§ 47-2602, 47-2605(h) (1968); MINN. STAT. § 297A. 25(k) (1972).

99. KAN. STAT. ANN. § 79-3602(j) (1969). Similarly, the Utah law defines "retail sale" to exclude isolated or occasional sales by persons not regularly engaged in business. UTAH CODE ANN. § 59-15-2(e) (Supp. 1973).

100. ALA. CODE tit. 51, §§ 786(2)-(36) (Supp. 1971).

101. P-H SALES TAXES, ALA. ¶ 22,276 (1973).

102. GA. CODE ANN. §§ 92-3402a-3403a (Supp. 1972).

for casual sales; rather, it taxes every person engaged in the business of selling tangible personal property, and it broadly defines business in the same manner as the Maryland statute. In *Novah v. Redwine*,[103] the Georgia court determined that the legislature did not mean to tax a casual or isolated sale, since the definition of the term "business" implied a continuity of transactions and not a single transaction.

The statutory exemption is obviously the most desirable for both taxpayers and tax collectors. Such an exemption is definite and hopefully clear and determinative. A reinstatement of the pre-1969 Maryland law would thus be beneficial for all concerned parties.

Unfortunately the realities of taxation must be faced. With the 1969 amendment, a grand and fertile field of tax revenues was opened. To return to the prior law would once again close off this area, and the tax authorities will probably be unwilling to lose this source of revenue. As an alternative, a new exemption dealing specifically with capital transactions could be added to section 326 of the Act. This type of legislative action may be more easily obtained, and therefore an examination of the law in other states will be of value in determining the scope and form of such a capital transaction exemption. Most states have not dealt with this question under their sales tax, probably due to the existence of broad casual sale exemptions. Where the issue has been considered, the treatment falls into one of five categories. These are: first, a statutory exemption for most capital transactions; second, statutory exemption for capital transactions in which ownership interests are of a continuing nature; third, statutory casual sale exemption made applicable to capital transactions by rulings or decisions; fourth, non-statutory casual sale exemption made applicable to capital transactions by rulings or decisions; and finally, imposition of sales tax on capital transactions. Those states which provide specific exemptions in their sales tax statutes allow exemptions for many kinds of capital transactions. The statutes of New York, New Jersey and Oklahoma are all examples of this technique. New York does not have a casual sale exemption, either in its statute or administrative regulations, and no judicial decisions have implied such an exemption. However, the term "retail sale" is defined so as to exclude the following types of transactions: the transfer of tangible personal property to a

103. 89 Ga. App. 755, 81 S.E.2d 222 (Ct. App. 1954).

corporation, solely in consideration for the issuance of its stock, pursuant to a merger or consolidation effected under the law of New York or any other jurisdiction; the distribution of property by a corporation to its stockholders as a liquidating dividend; the distribution of property by a partnership to its partners in whole or partial liquidation; the transfer of property to a corporation upon its organization in consideration for the issuance of its stock; and the contribution of property to a partnership in consideration for a partnership interest therein.[104] This list of exemptions does not include all capital transactions, and a reported Opinion of Counsel to the New York Tax Bureau emphasized that the statutory exemptions are limited to their terms.[105]

The New Jersey statute is basically the same and contains five exclusions, pertinent to this discussion, from the definition of "retail sale."[106] These provisions exempt transfers of tangible personal property to a corporation solely in consideration for the issuance of its stock, pursuant to a merger or consolidation; in a distribution of a liquidating dividend by a corporation; in a distribution of the property of a partnership to its partners in partial or full liquidation of the partnership; to a corporation upon its organization, in consideration for the issuance of its stock, and to a partnership in consideration for a partnership interest therein. There do not appear to be any regulations, rulings or cases which have construed this statute.

The last jurisdiction which has been selected for analysis is Oklahoma, which has a much broader statutory exemption for capital transactions.[107] Under this statute the following transfers of tangible personal property are exempted from the sales tax: transfers from one corporation to another corporation pursuant to a reorganization;[108] transfers in connection with the winding up,

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104. N.Y. TAX LAW § 1101(b)(4)(ii) (McKinney 1966).

105. 1 OP. COUNSEL N.Y. TAX BUREAU 46 (1967), P-H SALES TAXES, N.Y. ¶ 23,206 (1973). This involved a corporate reorganization pursuant to INT. REV. CODE of 1954, § 368(a)(1)(C) in which a New York corporation transferred its assets to a Delaware corporation in exchange for shares of stock of the acquiring company and the assumption of liabilities. The shares of stock of the acquiring company were distributed to the shareholders of the New York corporation, which was then liquidated. The opinion of counsel held that since this transaction was not consummated pursuant to a statutory merger or consolidation, the exemption in the statute did not apply to the consideration received by the New York corporation for tangible personal property transferred in the reorganization.

106. N.J. REV. STAT. §§ 54:32B-2(e)(3)(B)-(F) (Supp. 1972).

107. OKLA. STAT. tit. 68, § 1305a (Supp. 1972-73).

108. A reorganization is defined to mean (i) a statutory merger or consolidation, or (ii) the acquisition by a corporation of substantially all of the properties of another corpo-

dissolution or liquidation of a corporation, but only when there is a distribution in kind to the shareholders of the property of such corporation; transfers to a corporation for the purpose of organizing such corporation, where the former owners of the property transferred are, immediately after the transfer, in control of the corporation, and the stock or securities received by each is substantially in proportion to his interest in the property prior to the transfer; transfers to a partnership in the organization of the partnership, if the former owners of the property transferred are, immediately after the transfer, members of the partnership and their interests therein are substantially in proportion to their interests in the property prior to the transfer; and finally, transfers from a partnership to members thereof when made in kind in dissolution of the partnership. Once again, there do not appear to be any regulations, rulings or decisions which have interpreted these exemptions.

A more limited type of statutory exemption, one which reflects to some degree the incorporation or partnership formation exemptions of the Oklahoma law in requiring continuity of proportional interests, is found in Georgia.[109] This statute provides that the sales tax shall not apply to sales, transfers or exchanges of tangible personal property made as a result of a business reorganization, provided that the owners, partners or stockholders of the business being reorganized maintain the same proportional interests or shares in the new organization. Similarly, a California statute[110] provides that the term "occasional sale," a type of sale exempt from sales taxation under that statute, shall include:

> Any transfer of all or substantially all the property held or used by a person in the course of . . . [activities for which a sales tax seller's permit is required] 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 ownership 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.[111]

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ration when the consideration is solely all or a part of the voting stock of the acquiring corporation, or of its parent or subsidiary. OKLA. STAT. tit. 68, § 1305a (Supp. 1972-73).

109. GA. CODE ANN. § 92-3403a(c)(2)(K) (Supp. 1972).

110. CAL. REV. & TAX. CODE § 6006.5 (West 1970).

111. CAL. REV. & TAX CODE § 6006.5(b) (West 1970). Subsection (a) thereof is simi-

The third category of jurisdictions which have considered the sales tax implications of capital transactions have exempted such transactions from sales tax by application of a statutory casual sale exemption. This was accomplished judicially in Utah, where

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lar to the casual sale exemption which existed in Maryland prior to the recent amendment, and it includes within that term:

> A sale of property not held or used by a seller in the course of activities for which he is required to hold a seller's permit or permits or would be required to hold a seller's permit or permits if the activities were conducted in this state, provided such sale is not one of a series of sales sufficient in number, scope and character to constitute an activity for which he is required to hold a seller's permit or would be required to hold a seller's permit if the activity were conducted in this state. . . .

A recent regulation however, has expanded the application of this statute. Regulation 1595 incorporates a number of prior letter rulings reprinted in the sales tax services. Reported at P-H SALES TAXES, CALIF. ¶ 21,222-A (1973), it is headed, "Occasional Sale - Sale of a Business - Business Reorganization." Subpart (b) is concerned with the sale or reorganization of all or part of a business, and it provides as follows:

> (1) General. Tax applies to that portion of the gross receipts from the sale of a business that is attributable to the transfer of tangible personal property held or used in the course of activities [for which a seller's permit is or would be required] and acquired by the purchaser for use rather than resale, as, for example, showcases and office equipment. Tax does not apply, however, with respect to tangible personal property such as stock in trade, sold for the purpose of resale in the regular course of the purchaser's business.
>
> (2) Transfers of substantially all property without substantial change in ownership. Tax does not apply to a transfer of all or substantially all the property held or used by a person in the course of activities for which he is required to hold a seller's permit or permits or would be required to hold a seller's permit or permits if the activities were conducted in this state, provided that after the transfer the real or ultimate ownership of the property is substantially similar to that which existed before such transfer. "Substantially all of the property" means 80% or more of all the tangible personal property held or used in the course of activities, including tangible personal property located outside of this state. Stockholders, bondholders, partners, or other persons holding an ownership interest rather than a security interest in the corporation or other entity are regarded as having the real or ultimate ownership of the property of the corporation or other entity.
>
> The real or ultimate ownership is substantially similar to that which existed before a transfer if 80% or more of that ownership of the tangible personal property is unchanged after the transfer . . . .
>
> (3) Statutory merger or consolidation. Tax does not apply to a transfer of property of a constituent corporation to a surviving corporation or new corporation pursuant to a statutory merger or consolidation under . . . the California Corporation Code or similar laws of other states.
>
> (4) Contribution to commencing corporation or commencing partnership. Tax does not apply to a transfer of property to a commencing corporation or commencing partnership in exchange solely for first issue stock of the commencing corporation or an interest in the commencing partnership. Tax does apply, however, if the transferor receives consideration such as cash, notes, or an assumption of indebtedness, and the transfer does not otherwise quality for exemption. The tax is measured by the amount of such consideration attributable to the tangible personal property transferred.

it was held that the sales tax did not apply to the sale of an entire business which included the transfer of tangible personal property.[112] As noted earlier, that decision was based on an analysis of the intent of the legislature in enacting the statute.

Florida's law presents a similar approach but reaches a different result. The Florida sales tax law defines "business" to exclude occasional or isolated sales involving tangible personal property by a person not holding himself out as engaged in business.[113] An administrative interpretation[114] exempts some but not all business liquidation sales under this statutory provision. The rule states that the sale by a farmer of farm machinery or equipment, or by a fisherman of a boat or by a grocery store of fixtures would be exempt because the sellers involved are not engaged in the business of selling tangible personal property of a similar type. By contrast, it holds that a dealer in office equipment, furniture or appliances cannot make an exempt occasional or isolated sale when selling the furniture, fixtures and equipment involved in the operation of a business; this is because of the "definite similarity" between the commodity sold at retail and the equipment sold in liquidation of the business.[115]

A final example of interest in this category is the Iowa law, which was amended in 1963 following the decision in *Des Moines & Central Iowa Railway v. State Tax Commission.*[116] The amendment added a statutory exemption for casual sales and also provided a definition of that term.[117] The exemption has been the subject of two reported administrative rulings.[118]

While all of these rulings are concerned with the taxability of the sale of a business, the clear implication is that transfers on the formation of a business should also be exempt from sales tax.

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112. *See* note 46 *supra* and accompanying text.

113. FLA. STAT., § 212.02(9) (West 1971).

114. P-H SALES TAXES, FLA. ¶ 21,582, rule 318-1.37(2) (1973).

115. *Id.* The commentary on this rule in P-H SALES TAXES, FLA., notes that there is no specific mention in the law or regulations exempting the sale of an entire business, but it interprets the rule to exempt from taxation the sale of all businesses except those which consist of retail operations.

116. 253 Iowa 994, 115 N.W.2d 178 (1962).

117. IOWA CODE §§ 422.42.12, 422.45.6 (1971).

118. A letter from the division of retail sales and use tax dated May 13, 1973, reprinted in P-H SALES TAXES, IOWA ¶ 21,225.10 (1973), implies that no tax would be due on the sale of an entire business, whether the seller was a retailer or otherwise. An opinion of the Attorney General of Iowa dated December 18, 1970,*id.* at ¶ 23,051, holds that the casual sale exemption would apply to the sale of tangible personal property by the owner of a business who was liquidating that business, so long as he was not engaged in the business of selling taxable goods for profit at the time of sale.

When a sole proprietorship or partnership incorporates, the transfer is presumably in liquidation of the business of the transferee; and where a completely new business has been incorporated, any transfers of property in exchange for stock would generally be casual and isolated with respect to the transferor of the property. Thus, in the states of Georgia, Utah and Iowa, as well as other states which have statutory casual sale exemptions, most capital transactions should be exempt from the sales tax, just as they were in Maryland prior to the enactment of the amendment to our casual sale exemption. As should be apparent from the discussion of the *Kaiser* and *ACF* cases, about the only type of capital transaction which was taxable in Maryland prior to 1969 was the sale of a business as part of a series of similar sales.

The fourth category of jurisdictions which are being considered treat capital transactions as exempt pursuant to administrative or judicial interpretations of statutes that do not contain casual sale exemptions. In Indiana, for example, there is no exemption of any type, but the sales tax is made applicable only to a sale at retail by a retail merchant.[119] The statute implicitly exempts the transfer of tangible personal property on the sale of an entire business.[120]

It has already been noted that the Georgia law, which contains no casual sale exemption, does statutorily exempt capital transactions where continuity of ownership exists. Sales of businesses are also now non-taxable by administrative adoption of a judicially created casual sale exemption. The Georgia courts first established that the statute could not tax casual sales, which included the sale of an entire business,[121] and there now exists an administrative provision incorporating this principle.[122] It states that a sale in complete and bona fide liquidation is a casual sale exempt from the tax if it is made within a thirty day period or during such longer period as may be approved by the Commissioner of Revenue.[123]

A limited exemption for capital transactions has been developed by case law in Missouri, without reliance on a casual sale

119. IND. ANN. STAT. § 64.2651 (Supp. 1972).

120. *See generally* P-H SALES TAXES, IND. ¶ 21,222 (1973). A recent administrative ruling, 2 Ind. Rev. Digest No. 4 (Oct. 1, 1970), P-H SALES TAXES, IND. at ¶ 21,222.10, states that the transfer of a private vehicle to a corporation as a contribution to capital does not generate any sales tax liability.

121. *See* cases discussed at note 78 *supra*.

122. GEORGIA TAX REGS. §§ 560-12-1.07, 2(c), P-H SALES TAXES, GA. ¶ 21,616 (1973).

123. *Id.*

statutory or administrative exemption. In *National Dairy Products Corp. v. Carpenter*,[124] the court held that the transfer of certain tangible personal property by merger of a wholly-owned subsidiary into its parent was not subject to the sales and use tax. The decision turns on the definition of "purchase price," used in defining the measure of the tax, which the court declared implied a contract of sale or exchange. Since on the merger the transfer was by operation of law and not by contract for sale or exchange, the transfer was not taxable. This is basically the same approach taken in the opinions of the Attorney General of Maryland hereinbefore described which dealt with the recordation tax.

In the final category of other jurisdictions are those states which have determined to impose a sales tax on some or all capital transactions, either with or without a statutory or other casual sale exemption. Maryland, California and New York can be included here to a limited degree, but the only state falling squarely within this group is Colorado, in which state the sales tax statute has no exemption and broadly defines taxable sales to include all sales except those made for resale.[125] In *Palmer v. Perkins*,[126] the court held that the sale of an entire business was a taxable transaction. There a laundry, cleaning and dyeing business had been sold to the appellant, who had been held liable for use tax on the equipment and supplies included in the sale. The court conceded that this was a casual or isolated transaction, but it found that all sales not within the category of wholesale sales (sales for resale) are taxable retail sales unless specifically exempted and that there was no specific exemption for the sale of the business.[127] Neither is there any exemption for other forms of capital transactions.

CONCLUSION

While these jurisdictions are not the only states which have considered the application of the salex tax to capital transactions, they are representative of the various ways in which the tax has been so applied. The majority of states with a sales tax have not broadly applied the tax to capital transactions, either through

124. National Dairy Products Corp. v. Carpenter, 326 S.W.2d 87 (Mo. 1959).

125. *See* COLO. REV. STAT. §§ 138-5-2(6), 138-5-4(1)a (1963).

126. 119 Colo. 533, 205 P.2d 785 (1949).

127. *See also* Tobin v. Weed, 158 Colo. 430, 407 P.2d 350 (1965). There the court reiterated that there was no exemption for isolated or casual transactions in the Colorado sales or use tax.

specific interpretation of the tax laws or through failure to assert the application of the tax. By contrast the states of New York and California have developed rather specific techniques to handle this issue, which undoubtedly reflect the high volume of commercial activity in those states.

If Maryland is going to provide a capital transactions exemption, it would seem wise to follow the format which was developed in California. That approach recognizes the inequity of taxing transactions where economic substance and equitable ownership have not changed, but it also maintains some degree of tax neutrality. As the California law demonstrates, the result that only some capital transactions are taxed is not necessarily an anomaly. Despite a considerable body of laws and regulations which exempt a great many types of capital transactions, the California sales tax is nonetheless applied to capital transactions which are not specifically exempted. This again reflects the statutory scheme by which most sales tax statutes are drawn—the tax applies to every type of transaction except those which are specifically exempted. Where discretion is placed in the hands of administrators to determine, within the statutory exemptions, what transactions are exempt—such as is the case in California and Maryland—the rules can be interpreted to accommodate a variety of capital transactions. To reach this result, though, it is clear that a statutory basis must first exist.

The California statutory and regulatory scheme provides a general exemption for most capital transactions—incorporation, formation of a partnership, statutory merger, and combinations where interests are of a continuing nature—virtually all types of transactions except the actual sale of assets to totally unrelated third parties. This is premised on an occasional sale exemption in the statute and an additional exemption for capital transactions in which interests are of a continuing nature. Primarily, the tax is applied to capital transactions involving businesses which are otherwise liable for retail sales tax, but it can even be applied to businesses not normally subject to the sales tax, if sufficient sales of that type have been made in the period preceding the sale. The results obtained are generally reasonable and logical, and by adopting a similar approach, Maryland would benefit from the years of experience during which California authorities have refined their taxing tools.

It appears that attorneys in California as a matter of course give careful consideration to the sales tax consequences of every capital transaction, save perhaps those which fall squarely within

the statutory or regulatory exemptions. The sales tax implications of business proposals are probably given only slightly less attention than income tax consequences. Until the Maryland law is amended, and thereafter if the California approach is adopted, practitioners in this state will have to follow the same course and give even closer scrutiny to the effect of sales taxes on capital transactions.