

[Senate Bill 259](#) (Bates)

Date: 06/29/15

Program: Property Taxes

Sponsor: Author

Revenue and Taxation Code Sections 64, 480.1, 480.2, 480.9, 482, and 486

Effective: Immediately upon enactment, but applies to transfers on and after January 1, 2016

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Summary: Creates a new “change in ownership” event for legal entity owned real property that occurs when 90% or more of the direct or indirect ownership interests in that legal entity transfer in a planned single transaction.

Specifically, this bill:

- On or after January 1, 2016, requires reassessment of a legal entity’s real property holdings whenever 90% or more of its ownership interests transfer in a "single transaction." *§64(c)(1)(B)(i)*
- Defines "single transaction" to mean a plan consisting of one or more sales or transfers. *§64(c)(1)(B)(ii)(IV)*
 - Creates a rebuttable presumption that sales or transfers occurring within a 36-month period are part of a *single* transaction, thus allowing cumulative counting of ownership interest transfers to reach the 90% threshold. *§64(c)(1)(B)(ii)(IV)(ia)*
 - Creates a rebuttable presumption that sales or transfers are part of a single transaction when the transferees (buyer) are related persons/entities per federal law, thus effectively allowing counting of the cumulative ownership interests of all the related parties to reach the 90% or more threshold. *§64(c)(1)(B)(ii)(IV)(ib)*
- Excludes transfers that occur upon death (i.e., inheritance). *§64(c)(1)(B)(ii)(V)(ia)*
- Excludes sales of publicly traded corporate stock or partnerships occurring in regular trading activity on an established securities market. *§64(c)(1)(B)(ii)(V)(ib)*
- Requires the change in ownership event to be reported to the Board of Equalization (BOE) within 90 days. *§§480.1, 480.2, 482*
- Increases from 10% to 15% the penalty for failure to report legal entity reassessment events to the BOE. *§§480.1, 480.2, 482*
- Requires the BOE to notify assessors when legal entity reassessment events occur. *§480.9*
- Requires the BOE to report the reassessments occurring under the new trigger event and their economic impact by 2021. *§486*

Purpose: To trigger more frequent legal entity changes in ownership when 90% or more ownership interests in the legal entity sell or transfer without any one party to the transaction gaining control.

Fiscal Impact Summary: Annual property tax revenue increase of \$26 million.

Existing Law: For property tax purposes, real property is reassessed from its Proposition 13 protected value (called a “base year value (BYV)”) to its current market value only when a change in ownership occurs.¹

Change in Ownership. When a “change in ownership” occurs, the law requires the assessor to reassess the property to its current fair market value.² Different laws apply to a person who buys real estate and a person who buys a legal entity that owns real estate.

¹ California Constitution Article XIII A, [Sec. 2](#).

² California Constitution Article XIII A, Sec. 2; Revenue and Taxation Code Sections 60 - 69.5

Interests in Real Property. Revenue and Taxation Code (RTC) Section 61(j) provides that a change in ownership includes the transfer of any interest in real property between a corporation, partnership, or other legal entity and a shareholder, partner or any other person. As a general rule, the law requires a reassessment equal to the percentage interest transferred.

Interests in Legal Entities. RTC Section 64 sets forth the change in ownership provisions for the purchase or transfer of ownership interests (e.g., stock in a corporation, interests in a limited liability company, or interests in a partnership) in legal entities that own real property. As a general rule, under Section 64(a), transfers of ownership interests in legal entities do not constitute a change in ownership (and, therefore, no reassessment) of the legal entity's real property. However, there are two exceptions to the general rule:

- **Change in Legal Entity Control.** Section 64(c)(1) requires reassessment when any person or entity obtains control through direct or indirect ownership or control, of more than 50% of corporation voting stock, or obtains more than a 50% ownership interest in any other type of legal entity. The reassessment covers all real property owned by the acquired legal entity (and any entity under its control).
- **Cumulative Transfers by "Original Co-owners."**³ Section 64(d) requires reassessment when voting stock or other ownership interests representing cumulatively more than 50% of the total interests in a legal entity are transferred by any of the "original co-owners" in one or more transactions. The reassessment covers the real property previously excluded from change in ownership under Section 62(a)(2).

Existing statutes do not specify the method of counting indirect ownership of legal entity ownership interests.

Currently ownership interests of spouses are not counted together as a single unit, regardless of whether the ownership interests are separate property or community property. With respect to immediate families, parents, children, and siblings' interests are also counted separately for each person.

Self-Reporting Requirement. Existing law requires legal entities to file a change in ownership statement (LEOP COS)⁴ with the BOE within 90 days of a change in control or change in ownership under Section 64(c) or (d). In the case of a change in control under Section 64(c), the person or legal entity that *acquired* control of the legal entity is responsible for filing the LEOP COS. A penalty applies if it is not filed within 90 days. The penalty amount is 10% of the taxes applicable to the new base year value reflecting the change in control or change in ownership of the real property owned by the legal entity.

Requirement to File Upon Request. The BOE searches for unreported changes in control and ownership of legal entities under Section 64(c) and (d). Annually, the BOE canvasses legal entities with a query on the state income tax return. Additionally, the BOE monitors business publications. Assessors and other interested parties also send referrals reporting possible changes. Using these leads, the BOE sends a LEOP COS to the entity to complete and file with the BOE. A legal entity that fails to respond may incur a penalty.

³ **Proportional Ownership Interests Exclusion Creates "Original Co-owner" Designation.** Under Section 62(a)(2), a transfer of real property to a legal entity does not result in a reassessment if the transfer is merely a change in the method of holding title and the proportional ownership interests in the real property are *exactly* the same before and after the transfer. However, after a transfer of real property qualifies for this exclusion from reassessment, the persons holding ownership interests in the legal entity immediately after the transfer are considered "**original co-owners**" for purposes of tracking subsequent transfers by original co-owners of those interests. When such transfers cumulatively exceed 50%, the real property previously excluded from reassessment under Section 62(a)(2), is deemed to undergo a change in ownership, and is, therefore, subject to reassessment under Section 64(d).

⁴ Legal Entity Ownership Program (LEOP) Change of Ownership (COS) detailed on page 6 of this analysis.

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Proposed Law:

Transfers of Ownership Interests in Legal Entities: Change in Ownership Trigger Event. This bill provides that when 90% or more of the direct or indirect ownership interests in a legal entity transfer in a single transaction, the transfer of the ownership interests is a change of ownership of the real property the legal entity owns, including the real property owned by a legal entity under its control. A change in ownership triggers reassessment. *§64(c)(1)(B)*

"**Single transaction**" means a plan consisting of one or more sales or transfers of ownership interests that occur on or after January 1, 2016. *§64(1)(B)(ii)(IV)*

Rebuttable Presumption. There is a rebuttable presumption that a sale or transfer is part of a single transaction if *either* of the following occur:

- The transferees are persons described in Section 267(b) of Title 26 of the United States Code, which describes transactions between related taxpayers. *§64(1)(B)(ii)(IV)(ia)*
- The sales or transfers occur within a 36-month period, commencing on the date of the first sale or transfer of the ownership interests. *§64(1)(B)(ii)(IV)(ib)*

"**Control**" means control as described in RTC Section 64(c)(1)(A) – i.e., obtaining control through direct or indirect ownership or control of more than 50% of the ownership interests. *§64(1)(B)(i)*

Double Counting. Once an ownership interest transfer counts towards a transaction that triggers reassessment, that interest may not be counted again. *§64(f)*

Indirect Ownership Measurement. For purposes of Section 64(c), legal entity ownership interests owned by another legal entity will be considered as being owned by, or transferred to, its owners proportionately. *§64(c)(3)*

No Control Standard. Unlike existing law, under the proposed reassessment trigger it is immaterial whether or not any one legal entity or person acquires more than 50% of the ownership interests. *§64(c)(1)(B)(i)*

Inheritances Excluded. A transfers does not include those that occur upon death. *§64(c)(1)(B)(ii)(V)(ia)*

Securities Market Trades Excluded. A transfer does not include a sale of stock or interests in publicly traded corporations or publicly traded partnerships in the regular course of a trading activity on an established securities market. However, this exclusion is inapplicable if the shares are acquired as part of a merger, acquisition, private equity buyout, transfer of partnership shares, or any other means that otherwise triggers the new reassessment provision. *§64(c)(1)(B)(ii)(V)*

"**Legal entity**" means a corporation, a partnership, a limited liability company, or other legal entity. *§64(c)(1)(B)(ii)(III)*

"**Ownership interests**" means corporate voting stock, partnership capital and profits interests, limited liability company membership interests, and other ownership interests in legal entities. *§64(c)(1)(B)(ii)(III)*

Regulations. The BOE is authorized to prescribe any needed regulations. *§64(g)*

LEOP COS. Related to the LEOP COS required to be filed with the BOE, this bill:

- **Increases Penalty.** Increases the penalty from 10% to 15% for failure to file a LEOP COS with the BOE. *§§480.1, 480.2, 482*
- **FTB Questions.** Modifies the questions placed on franchise income tax returns to address the new change in ownership event. *§64(e)*
- **Requires Assessor Notification.** Requires the BOE to notify assessors if a change in ownership occurs as described by new Section 64(c)(1)(B) or existing Section 64(c). *§480.9*

Effective Immediately. This bill takes immediate effect, but applies only to transfers that first occur on or after January 1, 2016.

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In General: Property Tax System. In 1978, voters changed California's property tax system with the approval of [Proposition 13](#). Under this system, property is reassessed to its current market value only after a change in ownership or the completion of new construction. Generally, the sales price of a property is used to set the property's assessed value, and annual increases to that value are limited to the rate of inflation, not to exceed 2%. Under this system, a property's assessed value is based on its 1975 fair market value until the property changes ownership. Thereafter, annual assessed value increases are limited to 2% or the inflation rate, whichever is less. When the property changes ownership, it is reassessed to its current market value and future increases to that value are subject to the same limits.

Change in Ownership. While Proposition 13 provided a "change in ownership" reassessment trigger, it did not define this key phrase. The Assembly Revenue and Taxation Committee appointed a special Task Force to recommend the statutory implementation for Proposition 13 and define change in ownership. The Task Force consisted of 35 members, including legislative and BOE staff, county assessors, public and private sector attorneys, and trade associations.

The Task Force published its findings in **Report of the Task Force on Property Tax Administration**, California State Assembly Publication 723, January 22, 1979. The Assembly Revenue and Taxation Committee also published a report that contains additional background on defining change in ownership called **Implementation of Proposition 13, Volume 1, Property Tax Assessment**, California State Assembly Publication 748, October 29, 1979.

Property Owned by Legal Entities. One issue the Task Force faced was how to apply Proposition 13's change in ownership provisions to property owned by a legal entity. For instance, would a transfer of ownership interests in a legal entity that owns real property be considered a transfer of the real property interests and, thus, a change in ownership? The Task Force considered two alternatives: the "separate entity theory" and the "ultimate control theory."

- **Separate Entity Theory.** The separate entity theory respects the separate identity of the legal entity. Accordingly, as long as the legal entity owns the property it will not be reassessed, even if all of the ownership interests in the legal entity transfer.
- **Ultimate Control Theory.** The ultimate control theory looks through the legal entity to determine who holds the ownership interests and, thus, who has "ultimate control" of the legal entity. Under this theory, real property owned by the legal entity is reassessed only when a single holder of ownership interests gains control of the legal entity through the acquisition of a majority of the ownership interests.

The Task Force recommended the separate entity theory be adopted for two reasons. The Report states:

(a) The administrative and enforcement problems of the ultimate control approach are monumental. How is the assessor to learn when ultimate control of a corporation or partnership has changed? Moreover, when the rules are spelled out (and the Task Force actually drafted ultimate control statutes) it became apparent that, without trying to cheat, many taxpayers, as well as assessors, would simply not know that a change in ownership occurred. The separate entity approach is vastly simpler for taxpayers and assessors to understand, apply, and enforce. Transfers between individuals and entities, or among entities, will generally be recorded. Even if unrecorded the real property will have to be transferred (by unrecorded deed or contract of sale, for example). Taxpayers can justifiably be expected to understand that a transfer of real property is a change in ownership and must be reported to the assessor.

In 1979, the initially codified change in ownership definitions for ownership interests in legal entities were based on the separate entity theory, as recommended by the Task Force. However, thereafter, subdivision (c) of Section 64 was added to provide that a change in ownership occurs whenever there is a change in control by a transfer (or transfers) of more than 50% of the total ownership interests to a single person or entity.

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According to the Assembly Revenue and Taxation Committee's Implementation of Proposition 13, subdivision (c) of Section 64, "the majority-takeover-of-corporate stock" provision was added "out of a concern that, given the lower turnover rate of corporate property, mergers or other transfer of majority controlling ownership should result in a reappraisal of the corporation's property - an effort to maintain some parity with the increasing relative tax burden of residential property statewide, due to more rapid turnover of homes. It was also a trade-off for exempting certain transfers among 100% wholly-owned corporations⁵."

Tax Burden. The Task Force expressed concern that a tax burden shift to residential taxpayers could occur under its separate entity theory since commercial and industrial property changes ownership less frequently than residential property. The definitions originally proposed for legal entities using the separate entity theory were chosen to mitigate administrative difficulties. Because of this concern, the Task Force proposed that the Legislature study the idea of a constitutional amendment to periodically appraise commercial and industrial property at current market value noting:

[s]uch a constitutional change would also result in far greater simplicity in the treatment of legal entities. If commercial and industrial properties were to be periodically reappraised for reasons other than change in ownership, the difficult and controversial policy issues in choosing between the 'ultimate control' approach or 'separate entity' approach, outlined previously, would largely be avoided. The Task Force commends the principle of such a change to the Legislature for additional study.

Change in Ownership Tracking. RTC Section 255.7 requires the county recorder to provide the assessor with a copy of an ownership transfer document as soon as possible when a change in ownership is recorded. Assessors discover most real property changes in ownership via grant deeds or other documents recorded with the county recorder. However, real property owned by a legal entity may undergo a "change in ownership" with no grant deed or other document recorded that could alert the assessor to a reassessment. These types of changes in ownership are self-reported directly to the BOE by the entity involved.

LEOP. As noted previously, it is difficult for property tax administrators to independently discover reassessable events involving legal entities because ordinarily there is no recorded deed or notice of a transfer of an ownership interest in a legal entity. Because of these difficulties, the law requires the BOE to participate in the discovery of changes in ownership and changes in control of legal entities under Section 64(c)-(d).⁶

The BOE participates in this discovery through a program called the Legal Entity Ownership Program (LEOP). Under the LEOP, which started in January 1983, the BOE:

- Receives a list of legal entities from the Franchise Tax Board (FTB) that have reported a change in control or change in ownership on their income tax returns.
- Monitors business publications, such as *Mergers & Acquisitions* and the Wall Street Journal.
- Receives referrals from assessors as a result of information obtained in local publications or business property statement filings.
- Sends a LEOP COS called the "Statement of Change in Control or Ownership of Legal Entities" to each entity that might have experienced a change in control or ownership.
- Analyzes completed LEOP COS's to determine whether there has been a change in control or ownership.
- Notifies county assessors of changes in control and ownership.

⁵ Section 64(b) excludes transfers of ownership interests between affiliated corporations and Section 62(a)(2) excludes transfers which result in a change in the method of holding title to real property while the proportional ownership interests remain unchanged.

⁶ Chapter 1141 of the Statutes of 1981 (AB 152).

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Annual Canvassing. Section 64(e) requires an annual canvassing of legal entities via the state income tax return. The FTB transmits to the BOE the names and mailing addresses of the legal entities that report a change in control and/or a change in ownership on the income tax return for further investigation. The BOE makes a written request to the legal entity to file a LEOP COS to determine if it experienced a change in control or ownership or it obtained control of another entity that owned real property in California requiring reassessment.

The BOE also makes formal written requests to legal entities to investigate other possible changes in ownership based on information obtained from monitoring business publications and local assessors and interested parties' referrals. Additionally, at the local level, businesses are canvassed via the annual business property statement filed with the local assessor.

Consequences of Ultimate Discovery. Generally, the statute of limitations in Section 532 limits escape assessments to either four or eight years for prior tax years. But due to concerns with intentional concealment of legal entity changes in ownership, provisions enacted in the late 1990's removed the statute of limitations to ensure there would be no financial advantage to concealing the event. Thus, Section 532(b)(3) requires that an escape assessment be made for every tax year a legal entity fails to file the change in ownership statement required by Section 480.1 for a Section 64(c) change in control, or Section 480.2 for a Section 64(d) change in ownership.

Guide to Change in Ownership Reporting Statutes

RTC Section	Subject Click on link to view sample forms
64(e)	State Income Tax Return Questions <ul style="list-style-type: none"> • Corporate – Form 100 - Question J • Partnership – Form 565 - Question T • LLC - Form 568 - Question O • Filed with FTB • FTB transmits information to BOE
480	Change In Ownership Statement (COS) <ul style="list-style-type: none"> • Transfers of Real Property • Filed with local county assessor
480.1	LEOP COS <ul style="list-style-type: none"> • Transfers of Legal Entity Interests • Legal Entity Ownership Program (LEOP) • Change In Control under §64(c) • Filed with BOE
480.2	LEOP COS <ul style="list-style-type: none"> • Transfers of Legal Entity Interests • Legal Entity Ownership Program (LEOP) • Change In Ownership under §64(d) • Filed with BOE
481	COS and PCOR – Confidentiality
482	Failure to File Penalties <ul style="list-style-type: none"> • COS - §482(a) [Penalties related to §480] • LEOP COS §482(b) [Penalties related to §§480.1 and 480.2]
483	Failure to File Penalties – Penalty Abatement <ul style="list-style-type: none"> • COS §483(a) and (b) [Penalties related to §482(a)] • LEOP COS §483(c) [Penalties related to §482(b)]

Change in Ownership Legislation. The following table summarizes efforts to trigger more frequent reassessments of legal entity owned property.

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Year	Bill	Summary
2015	SB 259 (Bates)	Reassess when 90% of ownership interests transfer in a single planned transaction in a 3 year period. (Excludes death-related transfers)
2014	AB 2372 (Ammiano)	Reassess when 90% of ownership interests cumulatively transfer.
2013	AB 188 (Ammiano)	Reassess when 100% of ownership interests transfer in a single transaction in any rolling 3 year period.
2012	AB 2014 (Ammiano)	Convene legal entity task force to update the work done by the 1979 task force.
2011	AB 448 (Ammiano)	Reassess when 100% of ownership interests transfer in a single transaction in any rolling 3 year period.
2010	AB 2492 (Ammiano) 5/18/10 Version	Reassess when 100% of ownership interests transfer in a single transaction.
2010	AB 2492 (Ammiano) 4/8/10 Version	Reassess property owned by publicly traded companies every 3 years (rebuttable presumption). Property owned by other types of legal entities reassess in proportion to the percentage of ownership interests in the legal entity transferred.
2005	SB 17 (Escutia) As Amended	Reassess when more than 50% of the ownership interests transfer in a calendar year (excluding publicly traded companies).
2005	SB 17 (Escutia) As Introduced 12/06/04	Every 3 years reassess property owned by publicly traded companies (rebuttable presumption). Property owned by other types of legal entities reassessed in proportion to the percentage of ownership interests in the legal entity transferred.
2003	SB 17(Escutia)	Legislative intent to redefine change in ownership for nonresidential commercial and industrial property.
2003	SBx1 3 (Escutia)	Legislative intent to redefine change in ownership for nonresidential commercial and industrial property.
2002	SB 1662 (Peace)	Reassess nonresidential property when cumulatively more than 50% of ownership interests transfer. Broaden the state and local sales and use tax base and reduce both the state and local sales and use tax rate. (Legislative intent)
2001	AB 1013 (Leonard)	Reassess when more than 50% of ownership interests transfer.
2000	AB 2288 (Dutra)	Every 3 years reassess legal entity owned property. (Rebuttable presumption change in ownership occurred.) Possible income tax credit to homeowners based on fair market value of homes from additional revenue. Reduce the sales and use tax rate by 0.25%.
1991	SB 82 (Kopp)	Reassess when cumulatively more than 50% of ownership interests transfer.
1992 Prop. 167	Failed 41.16% - 58.84%	Among various tax related items, included a provision to modify legal entity change in ownership definitions. Proponent: California Tax Reform Association

Commentary:

1. **Purpose.** To trigger more frequent reassessments of property acquired by legal entities in situations such as the acquisition of a legal entity that owned the Fairmont Miramar Hotel in Santa Monica by Ocean Avenue LLC, which was recently the subject of litigation. (*Ocean Avenue LLC v. County of Los Angeles* (2014) 227 Cal. App.4th 344.)

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2. **This bill attempts to require assessors to reassess property following events that currently may not trigger a reassessment.** A new change in ownership triggering event is created to address cases in which the sellers of the legal entity transfer shares as part of a "single transaction" even if no one person or entity obtains control. Currently, "control" by one person is required to trigger reassessment. This primarily addresses the ability of persons to break up ownership into multiple legal entities to avoid reassessment (it also addresses the fact that married couples are not currently treated as a single unit). Two presumptions are created (discussed below) to help determine when shares have sold as part of a "single transaction."
3. **Reassessment examples.** Under this bill, reassessment may be required in the following situations where a company or business has real estate holdings:
 - A married couple buys a company with real estate holdings. (Under current law, ownership of the company is considered to be held 50/50 with neither spouse in control. Thus, this transfer does not meet the "change in control" test.)
 - A company's current managers or employees buy the company from the retiring owners and no one person acquires control.
 - A business (with no one in control) buys another competitor's business.
 - A business (with no one in control) buys a supplier.
4. **A "planned" transaction.** This bill appears more limited than similar legislation introduced in recent years in that the "single transaction" definition now requires the existence of a plan. The plan requirement raises numerous uncertainties for tax practitioners and administrators. What conditions rise to the level of a plan?
 - Does a plan require a detailed written document (or oral guidance) developed by expert counsel hired by the buyer to structure a non-reassessable transaction?
 - Does a plan require the consensual agreement of both the buyer and the seller?
 - If there is no coordinated plan by the transferors to sell, is the definition met? For example, when two partners sell their interests to unrelated transferees over a 36-month period (one partner retires) and 24 months later the other needs to liquidate for an unrelated reason, is this reassessable?
5. **The rebuttable presumption.** This bill also differs from prior legislation in that it adds a rebuttable presumption element. Generally, a rebuttable presumption is an inference that, in the absence of any evidence to the contrary, is to be made and accepted as an established fact. The presumption permits (but does not require) the BOE or county assessor to assume that certain sales or transfers are part of a single transaction when, in fact, they may not be. Usually presumptions are created for administrative convenience. However, if the BOE or county assessor chooses to investigate the transaction, the presumption may be rebutted by a review of other evidence. Where contradictory evidence exists the presumption may be overcome. Is a rebuttable presumption appropriate for both scenarios (36 months and related persons)?
6. **Rebutting the presumption.** As noted above, the BOE or assessor could choose to assert single transaction status when either of the two conditions is met without any investigation. If the taxpayer challenged the presumption, what evidence does the taxpayer present? More importantly, what precisely is being rebutted? That any pre-conceived plan existed or was contemplated? How could the taxpayer rebut a negative? That multiple transfers occurring on different dates were not part of a "single" transaction? For example, while there was a plan for two transfers that fell under the 90% threshold, a third unexpected transfer occurred within 36 months pushing the transaction over the threshold, but the third transfer was not part of the plan (or not part of an original "single transaction."

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7. **Discretion.** The bill appears to give both BOE and the assessor substantial discretion in change in ownership findings, such as the discretion to assert that a plan existed, and with respect to the evidence necessary to rebut the presumption. Is a conversation with the buyer enough for the BOE or assessor to rebut the presumption? These ambiguities could lead to inconsistent administration in the counties. What if the BOE and assessor disagreed over a LEOP CIO finding? Assessors can independently process a LEOP CIO.
8. **Related Transferees – Open Ended.** The related transferee provision does not have any time frame. Is it intended to be open ended (more than 36 months), or, is it intended to be limited to a single, non-cumulative transaction? Would a parent's plan to transfer 5% a year to children over a long term horizon trigger reassessment once the 90% or more threshold is reached?
9. **Spouses and Siblings – Single Unit.** Currently, interests owned by spouses are not treated as a single unit. This bill alters this longstanding rule. Furthermore, sibling interests would be treated as a single unit. Multiple generations would also be treated as a single unit: grandparent, parent, grandchild.
10. **Who are related transferees?** Under the federal law that this bill cross references, the following persons are considered related taxpayers.
 - Members of a family: the family of an individual shall include only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants; and
 - An individual and a corporation of which more than 50% in value of the outstanding stock is owned, directly or indirectly, by or for such individual;
 - Two corporations that are members of the same controlled group
 - A grantor and a fiduciary of any trust;
 - A fiduciary of a trust and a fiduciary of another trust, if the same person is a grantor of both trusts;
 - A fiduciary of a trust and a beneficiary of such trust;
 - A fiduciary of a trust and a beneficiary of another trust, if the same person is a grantor of both trusts;
 - A fiduciary of a trust and a corporation of which more than 50% in value of the outstanding stock is owned, directly or indirectly, by or for the trust or by or for a person who is a grantor of the trust;
 - A person and an organization to which section 501 (relating to certain educational and charitable organizations which are exempt from tax) applies and which is controlled directly or indirectly by such person or (if such person is an individual) by members of the family of such individual;
 - A corporation and a partnership if the same persons own
 - more than 50% in value of the outstanding stock of the corporation, and
 - more than 50% of the capital interest, or the profits interest, in the partnership;
 - An S corporation and another S corporation if the same persons own more than 50% in value of the outstanding stock of each corporation;
 - An S corporation and a C corporation, if the same persons own more than 50% in value of the outstanding stock of each corporation; or
 - Except in the case of a sale or exchange in satisfaction of a pecuniary bequest, an executor of an estate and a beneficiary of such estate.

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11. **Under current change in ownership definitions, when companies (i.e., legal entities) are purchased or otherwise acquired, whether their real property is reassessed to current market value generally depends on whether there is a change in control.**

Scenario 1 (Control): If one legal entity or person buys 100% of the ownership interests in another legal entity, then absent an exclusion, the law requires a **reassessment** of all the real property owned by the acquired legal entity. Since the acquiring legal entity or person obtains more than 50% of the ownership interest in the acquired legal entity under Section 64(c), this is a “change in control.”

Scenario 2 (No Control): If three **different** legal entities or persons buy 100% of the ownership interests in that same legal entity in equal shares, there is **no reassessment**. In this scenario, each new buyer only has a 33 1/3% ownership interest in the acquired legal entity and no one entity or person has control.

In both scenarios, the acquired legal entity has entirely new owners, but only Scenario 1 results in reassessment.

Date	Transaction	Reassessment
5/1/15	<p style="text-align: center;">Scenario 1</p> <p>Established Company (EC) buys 100% of the ownership interests in Startup Company (SC)</p> <p>SC owns 5 properties in various locations in California</p> <p>SC purchased properties in 2000, 2002, 2005, 2008, 2012</p>	<p style="text-align: center;">EC Obtains Control of SC</p> <p>Reassess all 5 properties to market value on May 1, 2016.</p>
5/1/15	<p style="text-align: center;">Scenario 2</p> <p>Three Venture Capitalists (VC₁, VC₂, VC₃) buy 100% of the ownership interests in SC in equal shares.</p>	<p style="text-align: center;">Neither VC₁, VC₂, or VC₃ singularly control SC: each have 33 1/3%</p> <p>No Reassessment of any SC-owned property</p> <p>The 5 properties retain the assessed value established at the time acquired by SC</p>

12. **New Change in Ownership Trigger Point.** This bill adds a new reassessment trigger event with respect to transfers of ownership interests in legal entities. Properties will be reassessed whenever 90% or more of a legal entity’s ownership interests are transferred. Currently, only if a transfer of ownership interests causes a “change in control” of the legal entity (i.e., pushing one person (or legal entity) up and over the 50% ownership interest threshold) is the property owned by that legal entity reassessed to its current value. This bill changes the law to require reassessment of Startup Company’s five properties in the Scenario 2 transaction discussed above.
13. **This bill attempts to treat the transfer of ownership interests in legal entities more like the transfer of real property interests.** Any transfer of **real property interests** results in a change in ownership, absent an applicable exclusion, while transfers of **ownership interests in a legal entity** do not result in a change in ownership of property owned by the legal entity unless Section 64(c)(1) or (d) are triggered. The bill’s proponents claim that the current system is inequitable. The following illustrates the disparate treatment:

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- **Transfer of Real Property Interest.** Four individuals each own a 25% interest in a property. Each sale of an individual's 25% interest in the property triggers a 25% reassessment. (ABCD to EFGH)
- **Transfer of Ownership Interest in Legal Entity.** If the same property is *owned by a legal entity* in which the same four individuals each own a 25% interest, a sale of an individual's 25% interest in the legal entity will not cause a reassessment of the property owned by the legal entity. This is true even if there is a complete turnover of ownership interests in a single event. Only if one person obtains control (defined as ownership interests of more than 50%) of the legal entity is reassessment triggered. (ABCD to EFGH)

Progression of Transactions	Transfer Date	Owners After Transfer	Percent Reassessed if <u>Real Property Interests</u> Transfer Under Current Law	Percent Reassessed if <u>Legal Entity Ownership Interests</u> Transfer Under Current Law	Percent Reassessed if <u>Legal Entity Ownership Interests</u> Transfer Under AB 1040
A sells 25% to E B sells 25% to F C sells 25% to G D sells 25% to H	01/01/16	EFGH	100%	0%	100%¹
E sells 25% to I	04/05/16	FGHI	25%	0%	
F buys G's 25% F buys H's 25%	09/10/17	FI 75%/25%	50%	100%²	
F buys I's 25%	10/15/18	F	25%	0% ³	
F sells 50% to J	12/30/19	FJ	50%	0% ⁴	
F sells 50% to K	01/30/20	JK	50%	0%	100%⁵

This bill provides that when 90% or more of the ownership interests in the legal entity transfer in a single transaction that occurs on or after January 1, 2016, a change in ownership of the legal entity will occur, resulting in reassessment of property owned by it.

This disparate treatment is illustrated in columns 4 & 5 of the following table. Column 6 shows this bill's reassessment consequences when legal entity ownership interest transfers. (Note: Only the first and last transfers that take place on January 1, 2016, and January 30, 2020, respectively, reflect the changes made by this bill. The other transfer examples reflect existing law.)

1 All New Owners – But No One in Control. Transfer of 100% of ownership interests. This bill's new change in ownership trigger point results in reassessment. Property reassessed to its market value on January 1, 2016.

2 Change in Control. On September 10, 2017, F acquires "control" of the legal entity; F now owns 75% of the legal entity's ownership interests. Current law requires a 100% reassessment of the property to its value on September, 10, 2017.

3 No Change in Control. F owns 100% of the legal entity as of October 15, 2018. But, since F previously obtained control of the legal entity on September 10, 2017, No reassessment under current law.

4 Loss of Control. F owns 50% and J owns 50%. No one controls the legal entity. While F has lost control, no one gained control. No reassessment.

5 Cumulative Transfer. 100% of the ownership interests are cumulatively transferred. Property reassessed to its value on January 30, 2020.

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14. **Is the transfer of ownership interests in legal entities without reassessment consequences unintentional?** The Proposition 13 Task Force debated the issue of how to treat sales and transfers of legal entity ownership interests. The Task Force recognized the potential long term effect of the original definitions noting "(t)he Task Force admits that some of its own recommendations, such as those regarding legal entities, while the best of a seemingly 'no-win' choice of options and adopted to mitigate administrative difficulties, may, in the long run, further exacerbate this [tax burden] shift to residential property because it will result in fewer potential commercial and industrial property transfers being recognized for reappraisal purposes." Consequently, the Task Force proposed that the Legislature later consider a constitutional change to periodically reappraise commercial and industrial property. In 2012, Assembly Member Ammiano introduced unsuccessful legislation (AB 2014) to create a new task force to study this issue. After nearly 35 years, this bill seeks to add a new definition to those initially created to cause more frequent reassessment when property is owned by a legal entity.
15. **This bill addresses ownership interests in legal entities that are transferred indirectly to another legal entity or person.** With sufficient planning and legal advice, it might have been possible to structure transactions that transfer property via a legal entity to new owners indirectly using multiple tiers of legal entities and minimize or preclude reassessment under the new change in ownership trigger. As such, this bill includes indirect ownership transfers and provides that indirect ownership interests should be proportionately counted.
16. **This bill affects all types of real property owned by a legal entity.** This bill does not differentiate between residential and commercial property. All types of real property owned by a legal entity (partnerships, limited liability companies, corporations, etc.) are subject to the new triggering event. Thus, this bill could impact single family homes, multi-family properties (such as apartments, duplexes and mobilehome parks), agricultural property, family farms,⁷ and small businesses.
17. **Williamson Act property.** In practical application, Williamson Act property and other property under contract and eligible for special assessment provisions (such as the Mills Act for historical property) will not be impacted *provided* the property remains under contract. The law requires these properties to be assessed at the *lowest* of three specified values. While a new base year value would be reset if a change in ownership occurs under the new trigger, this value would likely be greater and will not become the basis of assessed value.
18. **BOE Implementation Report to Legislature – Report Revenue Impact Rather than Economic Impact.** The BOE can report this bill's *revenue* impact by requiring assessors to track and report the necessary data. However, if an *economic* impact report is desired, then the Legislative Analyst's Office would be better suited. As such, the following amendment is suggested:
- 486.(a) The board shall report to the Legislature, no later than January 1, 2021, regarding the implementation of subparagraph (B) of paragraph (1) of subdivision (c) of Section 64, including, but not limited to, the economic-revenue impact and frequency of reassessments of real property owned by legal entities.
19. **What is a "split roll?"** Typically, the term "split roll" means taxing various property types (e.g., residential vs. commercial) according to a different tax rate or value standard. In the context of reassessment of legal entity owned property, some use the term to reference modifying the change in ownership provisions related to legal entity ownership interests to trigger more frequent reassessment, such as this bill proposes. A true "split roll" is not possible without a constitutional amendment.
20. **Modifying "Change in Ownership" provisions.** While Proposition 13 amended the constitution to provide that a "change in ownership" triggers reassessment, it did not define the phrase. Statutory language defines the term and specifies transfers included or excluded from a change in ownership.

⁷ The parent-child change in ownership exclusion does not apply to transfers of ownership interests in legal entities, except to the extent the [uncodified note](#) of Section 63.1 is followed [Section 2 of Stats. 1987, Ch. 48 (AB 47), as amended by Section 6 of Stats. 2006, Ch. 224 (SB 1607)].

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Thus, statutory amendments modifying the original statutory definitions are permissible.

21. **Related legislation.** AB 1040 (Ting) proposes similar legislation, but differs in that it does not provide an exception for transfers related to death. As a result, AB 1040 would result in more property being reassessed to current market value.

Administrative Costs: A detailed cost estimate is pending.

Revenue Impact:

Background, Methodology, and Assumptions. This bill requires real property owned by a legal entity be reassessed whenever 90% or more of the ownership interests in that legal entity are sold or transferred in a single transaction. "Single transaction" means a plan consisting of one or more sales or transfers of ownership interests on or after January 1, 2016 as defined. The bill subjects real property owned by legal entities to reassessment more often than under current law. The result is an increase in assessed value and an increase in property tax revenue.

Estimating the revenue increase is difficult, as we do not know how many times such transactions occur in California. However, based on a recent sample of large county assessment roll data, staff estimates 2014-15 legal entity owned real property assessed values to be \$646 billion.

Each year, the BOE conducts a study to determine the effective assessment level (i.e., the percentage difference between assessed value and market value) for commercial/industrial property in order to determine the assessment level for rail transportation property (the 4R Ratio). The latest study, based on the 2013-14 assessment roll, finds the effective assessment level is about 71%. Applying this ratio to the estimated legal entity owned real property assessed value, we estimate the current legal entity market value to be:

$$\$646 \text{ billion} / 71\% = \$910 \text{ billion}$$

We cannot predict the annual number of legal entity property reassessments under this bill. Change in control statements submitted to the BOE do not capture the number of past transactions. The data we do collect suggests the proportion of assessed value subject to reassessment is very small. Furthermore, in comparison with similar proposals in recent years, this bill may result in fewer reassessments than other proposals of its kind.

Assuming one percent of legal entity properties are subject to reassessment each year to current market value under this bill, and assuming legal entities may likely restructure their transactions to avoid reassessment, the estimated revenue impact at the basic 1% property tax rate is:

Legal Entity Assessed Value	4R Ratio	Legal Entity Market Value	Increase in Assessed Value	Revenue Gain
\$646 billion	71%	\$910 billion	\$264 billion	\$ 26 million

This bill would also increase the penalty from 10% to 15% of taxes due for failure to file legal entity change in control statements with the BOE. According to the BOE's County-Assessed Properties Division, transactions subject to this penalty are minimal, historically not more than 10% of all filings. Assuming an average assessed value for property owned by legal entities to be \$300,000, we estimate the revenue impact of increasing the failure to file penalty to be less than \$1 million annually. This amount may decrease over time as the increased penalty becomes a deterrent to late filing.

Revenue Summary. Based on the preceding assumptions, the annual revenue gain could amount to about \$26 million.

This revenue estimate does not account for any changes in economic activity that may or may not result from enactment of the proposed law.

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