DRAFT

STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date:	**04/30/13**	Bill No:	**Assembly Bill 561**
Tax Program:	**Property**	Author:	**Ting**
Sponsor:	**Author**	Code Sections:	**RTC 11911**
Related Bills:		Effective Date:	**01/01/14**

BILL SUMMARY

Related to the documentary transfer tax, this bill defines "realty sold" to include legal entity ownership interest transfers that trigger reassessment under "change in ownership" law.

ANALYSIS

CURRENT LAW

Change in Ownership. After a "change in ownership" occurs, the assessor reassesses a property to its current fair market value.[1] Different laws apply to a person who buys real estate and a person who buys a company that owns real estate.

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. Relevant to this bill, documents to convey the real property interests, such as a grant deed, are typically submitted to the county recorder for recordation.

Interests in Legal Entities. 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. The first occurs when there is a "change in control" of the legal entity. The second occurs when "original co-owners"[2] of the legal entity cumulatively transfer more than 50% of their original co-owner interests in that legal entity. Specifically:

- **Change in Legal Entity Control.** Section 64(c) 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

[1] California Constitution Article XIII A, Sec. 2; Revenue and Taxation Code (RTC) Sections 60 - 69.5

[2] **Proportional Ownership Interests Exclusion Creates "Original Coowner" 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 coowners**" for purposes of tracking subsequent transfers by original coowners 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).

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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**." 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).

Relevant to this bill, documents to convey ownership interests in a legal entity, such as stock shares, typically are not submitted to the county recorder for recordation.

Documentary Transfer Tax. RTC Sections 11901-11935 relate to the Documentary Transfer Tax (DTT) for counties and general law cities. Charter cities may also levy a DTT pursuant to a local ordinance and their own "municipal affairs" doctrine[3] authority. The DTT is a locally imposed excise tax. The tax attaches to the privilege of exercising the right to conveyance, and is imposed when "realty [is] sold." Typically, when documents are submitted for recordation, the county recorder collects the DTT.

The DTT Act does not define "realty sold." Two courts[4] and the California Attorney General[5] have held that "realty sold" and "change in ownership" have the same meaning.

> While the Document Transfer Tax Act does not define **"realty sold"** that phrase is sufficiently similar to the phrase **"change in ownership"** contained in the same code and governing an analogous subject, to warrant that **each phrase be defined to have the same meaning**. [6]

"Unrecorded" Changes in Ownership and the DTT. When a change in ownership occurs without any document recorded (unrecorded), existing law[7] allows city employees to access assessor confidential information to investigate whether a DTT should be imposed related to the property's change in control or change in ownership.

PROPOSED LAW

This bill provides that for purposes of the DTT, "realty sold" includes, but is not limited to, any acquisition or transfer of ownership interests in a legal entity that would constitute a change in ownership of that legal entity's real property as set forth in RTC Chapter 2 (commencing with Section 60) of Part 0.5 of Division 1.

IN GENERAL

The DTT was enacted by Ch. 1332 of the Statutes of 1967 and became operative on July 1, 1968 to replace the repealed Federal Documentary Stamp Tax (former 26 U.S.C.§§4361, 4363). After approval of an ordinance, a county may impose a documentary transfer tax on the realty value of deeds of transfer within that jurisdiction. The county rate is fifty-five cents ($0.55) for each five hundred dollars ($500) of value.

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[3] Under the California Constitution's "municipal affairs" doctrine, charter cities can levy taxes which have not been preempted by the state or federal governments (Article XI, §5)

[4] *Thrifty Corp. v. County of Los Angeles (1989)* 210 Cal. App. 3d 881, 886 and *McDonald's Corp v. Board of Supervisors (1998)* 63 Cal.App. 4th 612, 615-617

[5] 82 Ops.Cal.Atty.Gen. 56

[6] *Thrifty Corp. v. County of Los Angeles (1989)* 210 Cal. App. 3d 881, 886

[7] RTC 480.4

While the statutory rate is "per $500," in practice the rate is often expressed as $1.10 for each $1,000 of value. All of California's 58 counties apply the tax, which is modeled after the previously imposed Federal Stamp Tax. Each of California's 482 cities may also enact ordinances to impose the tax as follows:

General law cities (non-charter cities) may impose a DTT at half the county rate. The city tax applies as a credit against the county tax (i.e., the total rate will still be $0.55 for each $500 of value and the city and county will equally share in the proceeds). Presently, there are 361 general law cities.

Charter cities may impose a DTT at a higher rate under the municipal affairs doctrine of the California Constitution (Article XI, Section 5). If they impose a DTT at a higher rate than the non-charter rate, then the city DTT does not serve as a credit against the county tax. The city tax is referred to as the Documentary Transfer Tax, Real Property Transfer Tax, or Real Estate Transfer Tax. The RTC provisions do not apply to charter cities. Section 2 of Ch. 1332, Stats. 1967 provided that no city or county shall directly or indirectly impose a tax on transfers of real property not in conformity with Part 6.7, but the prohibition does not apply to charter cities or San Francisco (a city and county). Presently, there are 121 charter cities. About 30 charter cities impose a higher DTT rate – from the lowest at about $2.00 per $1,000 to the highest at $15.00 per $1,000.

DTT is an Excise Tax. The courts[8] have held that the DDT is an excise tax on the privilege of exercising the right to convey property. It is neither a property tax nor is it a transaction or sales tax on the transfer of real property, which is prohibited by Article XIIIA, Section 4 of California Constitution.

DTT Administration. The county recorder generally collects the DTT on behalf of the counties and cities when documents are presented for recording. However, cities and counties can impose the tax and pursue collection using such means as filing suit for delinquent DTT payment. By ordinance, cities and counties may establish an administrative appeal process to resolve DTT disputes.[9]

BACKGROUND

AB 563 (Stats. 2011, Ch., 320, Furutani) authorized the assessor to share confidential property tax information with cities. The City of Los Angeles sponsored this bill to gain access to information it needs to properly impose the DTT. The author noted that the bill "would allow for information sharing between the County Assessors' Office and cities to identify change of ownership legal entity transfers and other real property transfers that may not be currently captured."

SB 816 (Stats. 2009, Ch. 622, Ducheny) authorized the assessor to provide confidential information to the county recorder for purposes of investigating whether the DTT should be imposed. In addition, SB 816 added Section 11935 to expressly authorize a county board of supervisors to establish an administrative appeal process for the DTT and specify that the value determined for purposes of the DTT is not binding on the value determined for property tax purposes.

[8] *County of Los Angeles v. Southern Cal. Edison Co.* (2003) 112 Cal.App.4th 1108, *Fielder v. City of Los Angeles* (1993) 14 Cal.App.4th 137; *Fisher v. Alameda County* (1993) 20 Cal.App.4th 120; *City of Huntington Beach v. Superior Court* (1978) 78 Cal. App. 3d 333, 340-341, *Ingels v. Riley* (1936) 5 Cal.2d 154, 159-160

[9] RTC Section 11935

COMMENTS

1. **Sponsor and Purpose.** The author is sponsoring this bill to bring the DTT Act into conformity with the definition of "realty sold" under California property tax law. The author states that "this clarification is necessary because the change in ownership of a legal entity does not require a recorded instrument that would inform county recorders of the change in ownership and subsequent transfer tax due. This bill would simply ensure that the transfer tax is applied equally across all property owners based on existing definitions in statute, eliminating confusion about when transfer tax is due."

2. **This bill explicitly provides that "realty sold" in the DTT Act has the same meaning as "change in ownership" under Property Tax Law with respect to legal entity ownership interests.** This codifies existing case law and is consistent with a subsequent California Attorney General Opinion. While the bill's language is specific to legal entity ownership interest transfers that result in a change in ownership, the bill also states that "realty sold" *includes* this particular type of change in ownership and *is not limited to* other types of change in ownership.

3. **This bill's opponents argue that it is improper to interject the legal entity "change in ownership" concept into the DTT setting.** Opponents state this bill expands the definition of "realty sold" to circumstances in which there is no "transfer."

4. **Recently, some counties and cities have updated their DTT ordinances to explicitly address legal entity changes in ownership and enforce the collection of the DTT on such transfers.** These include:

   - Napa: Ordinance No. 1362
   - Los Angeles: Chapter 4.60 of the Los Angeles County Code
   - San Francisco: City and County of San Francisco Business and Tax Regulations Code Article 12-C, Section 1114
   - Santa Clara: County of Santa Clara Code Section A30-39.6

5. **The Los Angeles County Registrar-Recorder includes a "Notice – Collection of DTT for Legal Entity Changes in Ownership" on its website:** The county's website states:

   > The Los Angeles County Registrar-Recorder/County Clerk ("RRCC") began enforcing collection of Documentary Transfer Tax ("DTT") on legal entity transfers **where no document is recorded**, but which resulted in a greater than 50% interest in control of the legal entity being transferred. The collection is made pursuant to Chapter 4.60 of the Los Angeles County Code, and California Revenue and Taxation Code (" RTC ") sections 11911 and 11925, and is consistent with case law which defines "realty sold" as having the same meaning as changes in ownership for property tax purposes in RTC section 64(c)(1). In addition, effective January 1, 2010, RTC section 408 was amended to allow recorders to obtain information pertaining to these transfers from the Assessor. As a result, in an effort to collect the tax, the RRCC will continue to identify, and send notices for, properties where a change of ownership occurred which transferred a greater than 50% controlling interest in the legal entity thereby creating a liability for the DTT.

6. **San Francisco established a Transfer Tax Review Board to consider DTT appeals.** In a superior court decision specific to San Francisco's DTT ordinance, *Roman Catholic Archbishop of San Francisco v. City and County of San Francisco, Case No. CSG-10-49875* the court reversed the transfer tax review Board's holding that the DTT was applicable for various reasons. However, one issue in dispute in these hearings was the meaning of the phrase "realty sold" given the lack of definition. The superior court also noted the two appellate cases and the AG opinion that "realty sold" has the same meaning as "change in ownership" for transfer tax purposes. The superior court's decision was not appealed.

COST ESTIMATE

The BOE would incur some minor absorbable costs to inform and advise cities, counties, the public, and staff of these provisions.

REVENUE ESTIMATE

This bill has no state or property tax revenue impact.

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