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Executive Director

March 29, 2002

**RE: *Classes/Series of Interests in LLC's - Section 62(a)(2)***

Dear Mr.       :

As you know, your request for an opinion, originally addressed to the Property Taxes Section of the Board, concerning whether, if the "separate series rules" of the Delaware Limited Liability Company Act are complied with, each series will be viewed as a separate "entity" for purposes of the California property tax change in ownership rules governing reassessment, has been referred to the Legal Division for reply. Upon analysis of the issues you present, and for the reasons set forth below, we conclude that the transfers you describe in your letter are excluded from change in ownership for property tax purposes and, consequently, would not subject the properties involved to reassessment.

For purposes of this opinion, you have asked us to assume that A and B own Property X, and C and D own Property Y. You recognize that if A and B form a limited liability company to own Property X, in exchange for LLC ownership interests equal to their original property ownership interests, the transfer of the Property from A and B to the LLC would be excluded from the definition of change in ownership, and thus from reappraisal, by the provisions of Revenue and Taxation Code section 62, subdivision (a)(2), because the transfer would result only in a change in the method of holding title to the real property, and in which proportional ownership interests would remain the same after the transfer. The same, of course, would be true for a similar transfer with respect to C and D and Property Y.

On the other hand, if A, B, C and D contribute both their properties to a single limited liability company in exchange for ownership interests in the LLC, thereby receiving indirect interests in a property other than that which they originally owned, section 62(a)(2) would not apply, and there would be a reappraisal of both of the properties. See Property Tax Rule 462.180, Example 3 under subdivision (b)(2).<sup>1</sup>

Your question, however, is whether, if A, B, C, and D transfer the properties to a qualified Delaware LLC, under the Delaware separate series statutes, and if A and B are the sole

<sup>1</sup> Example 3 provides: "A transfers Whiteacre to Corporation X and B transfers Blackacre (equal in value to Whiteacre) to Corporation X. A and B each take back 50 percent of the stock. Change in ownership of 100 percent of both Whiteacre and Blackacre."

owners of the Series A ownership interests of the LLC, and C and D are the sole owners of the Series B ownership interests, and each series is entitled to 100% of the income and expenses of its respective, separate property and does not have the liability or exposure for other series (in other words, if each series is tantamount to a separate LLC), is each series deemed to be a separate "entity" under the California property tax rules? While we do not agree that each series of coownership interests should be treated as a separate legal entity, we have concluded that the exclusion in section 62(a)(2) would apply.

Some time ago, the Delaware Legislature amended the Delaware Limited Liability Company Act to provide that a Delaware LLC "may establish or provide for the establishment of designated series of members, managers or limited liability interests having separate rights, powers or duties with respect to specific property or obligations of the limited liability company or profits and losses associated with specific property or obligations and, to the extent provided in the limited liability company agreement, any such series may have a separate business purpose or investment objective." See Section 18-215, subd. (a) Delaware Law of Corporations and Business Organizations.

That law further provides that: ". . . in the event a limited liability company agreement creates 1 or more series, and if separate and distinct records are maintained for any such series and the assets associated with any such series are held (directly or indirectly, including through a nominee or otherwise) and accounted for separately from the other assets of the limited liability company, or any other series thereof, and if the limited liability company agreement so provides, and notice of the limitation on liabilities of a series as referenced in this subsection is set forth in the certificate of formation of the limited liability company, then the debts, liabilities and obligations incurred, contracted for or otherwise existing with respect to a particular series shall be enforceable against the assets of such series only, and not against the assets of the limited liability company generally or any other series thereof, and, unless otherwise provided in the limited liability company agreement, none of the debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to the limited liability company generally or any other series thereof shall be enforceable against the assets of such series. The fact that a certificate of formation that contains the foregoing notice of the limitation of liabilities of a series is on file in the office of the Secretary of State shall constitute notice of such limitation on liabilities of a series." Id., subd. (b).

Under the transfers you pose, although A, B, C and D all transfer their respective interests in Properties X and Y to the same LLC, under applicable Delaware Law, implemented by the Limited Liability Company Agreement specific to the subject LLC, A and B, through the ownership of the Series A membership shares, effectively retain sole ownership interests in the capital and profits of the LLC attributable to Property X, while C and D, through the ownership of the Series B membership shares, retain the sole ownership interests in the capital and profits attributable to Property Y. Thus, upon any distribution and/or upon the dissolution of the LLC or either series thereof, the members will receive only the amount of cash or assets from each respective series of interest of which they are a member, in accordance with each member's percentage interests in such class. For example, if Property X were to be sold, only A and B, as the sole members and owners of the Series A interests would receive the proceeds of such sale in proportion to their original ownership interests in Property X.

Thus, proportionality will be maintained from creation through distribution or dissolution of the LLC, relative to the property represented by a given class or series of interests and according to the members' respective percentages of interests in each series. Each LLC member will own the same percentage of capital and profits through the given Series of membership interests in the LLC as he/she directly owned in his or her respective parcel before the transfer to the LLC.

This result conforms with the Legislative scheme set forth with respect to change in ownership generally, and section 62(a)(2) specifically.

Revenue and Taxation Code Section 60 defines "change in ownership" as a "transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest."

Within that definition is the provision of section 61(j), which includes as a change in ownership:

\* \* \*

(j) The transfer of any interest in real property between a corporation, partnership, or other legal entity and a shareholder, partner, or any other person.

However, as is noted above, an important exclusion applicable to transfers to legal entities is found in section 62(a)(2), which provides that a change in ownership shall not include:

Any transfer between an individual or individuals and a legal entity or between legal entities, such as a cotenancy to a partnership, a partnership to a corporation, or a trust to a cotenancy, which results solely in a change in the method of holding title to the real property and in which proportional ownership interests of the transferors and transferees, whether represented by stock, partnership interest, or otherwise, in each and every piece of real property transferred, remain the same after the transfer.

This statutory exclusion is interpreted by Property Tax Rule 462.180 in subdivision (b)(2), (18 California Code of Regulations 462.180), which provides specifically with regard to legal entities - including LLCs, the following relevant language:

(b) EXCEPTIONS.

\* \* \*

(2) Transfers of real property between separate legal entities or by an individual to a legal entity (or vice versa), which result solely in a change in the method of holding title and in which the proportional ownership

interests in each and every piece of real property transferred the property remain the same after the transfer. (The holders of the ownership interests in the transferee legal entity, whether such interests are represented by stock, partnership shares, or other types of ownership interest, shall be defined as "original co-owners" for purposes of determining whether a change in ownership has occurred upon the subsequent transfer of the ownership interests in the legal entity.) . . .

While the term "ownership interests" used in section 62(a)(2) is not defined in the code or in the Property Tax Rules which interpret section 62(a)(2), the identical term is used in sections 64(a), 64(c), and 64(d), and is defined in Rule 462.180(d)(1) which interprets those provisions. The language of subsection (d)(1) of the rule makes clear, in our view, that the term "ownership interests" for control purposes has the same meaning for purposes of section 62(a)(2). (See also Annotation No. 220.0387, C 10/21/88 and C 6/19/98 enclosed.)

In this regard, Rule 462.180(d)(1), in effect, defines "ownership interest" as used in section 64(a) as the voting stock in a corporation, or the "total interest in partnership capital and . . . profits." Accordingly, it is these measures of "ownership interest" to which we look in determining the applicable interests in entities, such as LLC's. As discussed above, in the LLC at issue, the "ownership interests," which we assume include both capital and profits interests, clearly are retained by the transferors of the real properties involved. The transferors of Property X, A and B, and the transferors of Property Y, C and D, respectively, will retain the total capital and profits interests only in the property which they previously owned outright, based on the specific series of LLC interests exclusive to each property after the transfer.

Moreover, we note that Section 18-215(e) of the Delaware Limited Liability Company Act provides that "A limited liability company agreement may grant to all or certain identified members or managers or a specified class or group of the members or managers associated with a series the right to vote separately or with all or any class or group of the members or managers associated with the series, on any matter. Voting by members or managers associated with a series may be on a per capita, number, financial interest, class, group or any other basis."

Thus, based on the foregoing, that manager(s) may represent both series of interests in terms of operating decisions does not destroy the proportionality of the members' interest - assuming the manager(s) hold no interests in either capital or profits. The sole reason for concluding the existence of proportionality is that both before and after the transfers to the LLC, Property X will be owned 50 percent by A and 50 percent by B, and Property Y will be owned 50 percent by C and 50 percent by D, as the sole members of their respective series ownership interests in the LLC, representing their specific respective properties, as permitted by controlling Delaware law. This is consistent with our recently stated views on similar factual patterns presented. See, for example Cazadd 8/17/99 Letter (currently supporting Annotation No. 220.0385), and Cazadd 3/28/00 Letter (both enclosed).<sup>2</sup>

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<sup>2</sup> This position appears, however, to be inconsistent with the other letter supporting Annotation No. 220.0385 (Eisenlauer 3/12/92 Letter). However, that letter, involving a factual pattern centering upon a *Limited Partnership*, appears to be distinguishable. In addition, that letter concluded that, because of observed

It is important to note however that where - as here - the application of the exclusion in section 62(a)(2) occurs, and a transfer into a legal entity is excluded from change in ownership, the transferors (A and B, and C and D, respectively) become the "original coowners." Under the provisions of section 64(d), if the "original coowners" should in the future transfer cumulatively more than 50 percent of the interests in their portions of the legal entity (LLC), there would a change in ownership and reappraisal of all of the affected property previously transferred into the entity (LLC) under the section 62(a)(2) exclusion. Section 64(d) states the following:

If property is transferred on or after March 1, 1975, to a legal entity in a transaction excluded from change in ownership by paragraph (2) of subdivision (a) of Section 62, then the persons holding ownership interests in that legal entity immediately after the transfer shall be considered the "original co-owners."

Whenever shares or other ownership interests representing cumulatively **more than 50 percent of the total interests** in the entity are **transferred** by any of the **original co-owners** in one or more property transactions, a change in ownership of that real property owned by the legal entity shall have occurred, and the property that was previously excluded from change in ownership under the provisions of Section 62(a)(2) shall be reappraised.

The date of reappraisal shall be the date of the transfer of the ownership interest representing individually or cumulatively more than 50 percent of the interests in the entity.

Rule 462.180(d)(2) is the pertinent rule provision which interprets Section 64(d) and explains how and when it is to be applied:

(d) EXCEPTIONS.

\* \* \*

(2) When on or after March 1, 1975, real property is transferred to a partnership, corporation, limited liability company, or other legal entity and the transfer is excluded from change in ownership under Section 62(a)(2) of the Revenue and Taxation Code, and the "original co-owners" subsequently transfer, in one or more transactions, cumulatively more than 50 percent of the total control or ownership interests, as defined in subdivision (d)(1), in that partnership, corporation, limited liability company or legal entity, there is a change in ownership of only that property owned by the entity which was previously excluded under Section 62(a)(2). However, when such transfer would also result in a change in control under Section 64(c) of the Revenue

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and Taxation Code, then reappraisal of the property owned by the corporation, partnership, limited liability company, or other legal entity shall be pursuant to Section 64(c) rather than Section 64(d).

Thus, most transfers of interests in a legal entity (LLC) by the "original coowners" must be "cumulated" or counted as a "transfer" for purposes of determining a future change in ownership under Section 64(d). When and if the cumulative "transfers" by original coowners exceed 50 percent of the total interests in the LLC, the real property previously excluded from change in ownership by Section 62(a)(2) would be removed from the benefits of the exclusion and undergo reassessment.

The views expressed in this letter are advisory only; they represent the analysis of the legal staff of the Board based on present law and the facts set forth herein, and are not binding on any person or public entity.

Sincerely,

*/s/ Daniel G. Nauman*

Daniel G. Nauman  
Senior Tax Counsel

DGN:tr  
prop/prec/lc/02/02dgn

Enclosures

cc: Mr. David Gau, MIC:64  
Chief of PPSD, MIC:64  
Mr. Charles Knudsen, MIC:62  
Ms. Jennifer Willis, MIC:70



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Controller, Sacramento

E. L. SORENSEN, JR.  
Executive Director

August 17, 1999

In Re: **Change in Ownership – Section 62(a)(2) Transfer of Real Properties  
from Partnerships to Bankruptcy Remote LLC.**

Dear Mr. \_\_\_\_\_ :

This is in response to your letter of August 9, 1999 to Board Member Claude Parrish, in which you requested our opinion concerning the application of the change in ownership exclusion in Revenue and Taxation Code Section 62 (a)(2) to the transaction described below. In as much as the property is located in five different California counties, we are sending a copy of this opinion to Board Members representing these counties as well as to Mr. Parrish. The facts as we understand them are these:

**1. Existing Ownership.**

One individual, two trusts (in which that individual is the sole income beneficiary), and two partnerships (referred to as “California Owners”) own 14 parcels of real property located in Los Angeles, Orange, San Diego, San Bernardino, and San Luis Obispo counties (the “California Realty”). Other family-owned entities (“Other Owners”) own property located outside California (“Other Realty”). None of the California Owners are “original coowners” within the meaning of Section 62 (a)(2) and Section 64 (d).<sup>1</sup>

**2. Proposed Transaction.**

The California Owners and the Other Owners propose to transfer the California Realty and the Other Realty to a newly formed bankruptcy remote entity (called “W LLC Holdings”), in order to satisfy the requirements of their lender to hold the realty in an entity responsible for repayment of the loan which has waived bankruptcy and similar rights. To accomplish the transfer in a manner satisfactory to the bank and to allow each of the present owners to retain their respective interests, they propose to maintain the proportionality of their ownership in each property as follows:

- a.) California Owners and Other Owners will contribute the California Realty and Other Realty to W Holdings LLC in exchange for specific series of membership interests;

<sup>1</sup> Under Section 64(d), “...Whenever shares or other ownership interests representing cumulatively more than 50 percent of the total interests in the entity are transferred by any of the original co-owners in one or more property transactions, a change in ownership of that real property owned by the legal entity shall have occurred, and the property which was previously excluded from change in ownership under the provisions of Section 62(a)(2) shall be reappraised.”

- b.) W Holdings LLC will issue to California Owners and Other Owners a unique series of membership interests, representing the economic interests in the specific parcels of California Realty or Other Realty currently owned and contributed by each person or entity to W Holdings LLC;
- c.) Each member's interests in a specific series of membership interests and the particular California Realty or Other Realty which that series represents will be exactly proportional to the interests each California Owner holds directly and indirectly in each parcel of California Realty (shown in Schedule B of the W Holdings LLC Agreement, attached). Thus, W Holdings LLC will issue Series 1 through Series 7 membership interests to the California Owners, so that each California Owner will own the same percentage of capital and profits through that Series as the California Owner directly owned in the parcels of California Realty before the transfer to W Holdings LLC.

In your opinion, no aspect of the transaction triggers a change in ownership either directly or indirectly, provided that the proportional interest exclusion in Section 62 (a)(2) applies. For the reasons hereinafter explained, we agree.

#### **LAW AND ANALYSIS**

The Section 62 (a)(2) exclusion from change in ownership applies to proportional interest transfers between individuals and a legal entity and between a legal entity and individuals, which result solely in a change in the method of holding title to the real property and the proportional ownership interests of the transferors and transferees, in each and every piece of real property remain the same after the transfer. In order for the transfers of real property from the individuals, trusts and partnerships to the newly formed W Holdings LLC to be proportional, each LLC member's percentage of the capital and profits interests in the LLC must be identical to the interests held in each real property before the transfer and must represent in the same real property interests held by each in the LLC after the transfer.

The sole question in the instant case is whether, the real property transfers to W Holdings LLC satisfy the proportionality requirements of Section 62 (a)(2). In reaching a determination on this question we turn to the express language and representations made by the members in their LLC Operating Agreement,<sup>2</sup> and based on that agreement and its attached schedules, we conclude that the requirements of Section 62 (a)(2) are met:

The interests in each and every piece of property remain the same after the transfer. If any interests change our answer would not be the same.<sup>3</sup>

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<sup>2</sup> Where taxpayers are asserting the existence of a valid partnership or any legal entity with their interests represented in certain percentages, the assessor is entitled to treat such partnership or entity as valid, and the partners' express intentions with regard to their **capital** and **profits** interests as controlling, based upon the terms of the partnership or entity agreement. (See *Maletis v. United States* (1952) 200 F.2d 97, 98, wherein the court held that the burden is on the taxpayer to establish that the form of business he has created for tax purposes, and has asserted in his tax returns is valid with the interests specified therein, is in fact not a sham or unreal, and if it is in fact unreal, the government and not the taxpayer should have the sole power to sustain or disregard the effect of the fiction in order to check opportunities for manipulation of taxes.) In the instant case therefore, the Agreement sets forth the particular interests held by each of the members in the LLC capital and profits.

<sup>3</sup> For example, the percentage of interests of each partner in a new limited partnership did not correspond exactly to the capital and profit interests each held prior to the merger in Annotation No. 220.0245 and Annotation No. 220.0489, attached.

Pursuant to the *LLC Operating Agreement of W Holdings LLC*, the members of the LLC will be divided into 33 different groups or "Membership Series." In Article 6(a), "*Series; Percentage Interests*," the Agreement states that the Members of the LLC shall be divided into "Series 1 Members, 'Series 2 Members,' and such other series of Members, each having a different number, as the Manager shall establish." Accordingly, each membership interest in the LLC is associated with one series. And each series of members (Series 1 Members, Series 2 Members, etc.) shall have separate rights, powers, and duties with respect to specific property owned by the LLC. (Article 6 (b).) Schedule C (copy attached) sets forth the specific properties concerning which each series member shall exercise separate rights, powers, and duties, and Article 6 (c) states that the members of a given series shall have no voting rights or interest with respect to any other series or its property.

As to the distribution of cash or assets and the ultimate dissolution of W Holdings LLC, Article 7 of the Agreement requires the manager to distribute annually only the amount of cash (available for distribution) from each series pro rata to the series member in accordance with each member's percentage interests in such series. Similarly, the language in Article 9 allocates all income, gain, loss, deduction and credit related to the property of a given series among the members in such series "in proportion to their respective percentage interests." Upon dissolution of W Holdings LLC, Article 18 provides that its assets and liabilities shall be liquidated and the cash proceeds (including capital contributions) shall be applied, 1) to pay the debts of the LLC (with the cash from each series to pay the liabilities and expenses of that series), 2) to cover necessary debts and reserves owing to the members, and 3) to distribute the remaining cash from each series pro rata to the members of that series in proportion to their positive capital accounts.<sup>4</sup>

With respect to the interests of the "manager" of W Holdings LLC, Article 10 of the Agreement states that the "Management of the company shall be vested in a single manager who may (but need not) be a member of the company." The manager (named as "W Management LLC") is entitled to receive a reasonable fee, commission or other compensation as determined by the manager. Based on the information stated in your letter and as shown on Schedule B "*Initial Capital Contributions*" (copy attached), the manager does not have any membership interest (either capital or profits) in W Holdings LLC. Moreover, the manager will not be a member (either directly or indirectly) of any series (Series 1 through Series 7) which own membership interests in the California Realty. As such, the manager is not acquiring any membership interests which would result in a shift the proportionality before and after the transfer.

Based on the foregoing, this transfer falls squarely within the Section 62(a)(2) exclusion. For example, Irwin owns 100% of Parcels 3, 5, 9, 14, 15, 16, and 17 as an individual. In exchange for his contribution of each of these Parcels to W Holdings LLC, Irwin will receive 100% of the Series 1 membership interests in W Holdings LLC. If one day after the transfer, W Holdings LLC dissolved/liquidated, Irwin would receive back (in return for the Series 1 membership interests) Parcels 3, 5, 9, 14, 15, 16, and 17. Assuming this is a direct application of the language in the Agreement, the results are consistent with Section 62(a)(2). Each California Owner will own the same percentage of capital and profits through a given Series of membership interests in W Holdings LLC as the California Owner directly owned in that Owner's respective parcels of California Realty before the transfer to W Holdings LLC.

If however, this proposed transaction is undertaken as described, and the individuals, trusts, and partnerships now transfer their respective interests in the California Realty to W Holdings LLC utilizing the Section 62(a)(2) exclusion, they will be classified as "original coowners" for purposes of counting future transfers of W Holdings LLC interests under Section 64(d).

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<sup>4</sup> If the manager uses funds from one series to meet liabilities of another series, Article 16 of the Agreement states that the series whose funds are used has a right to recover those funds, the end result of which is that the burden of any failure of the "supported series" to repay is borne by all of the other series members in proportion to the relative fair market values of the assets (property) held by each series.

August 17, 1999

The views expressed in this letter are only advisory in nature. They represent the analysis of the legal staff of the Board based on the present law and facts set forth herein. Therefore, they are not binding on any person or entity.

Sincerely,

*/s/ Kristine Cazadd*

Kristine Cazadd  
Senior Tax Counsel

Attachments:  
(Annotated letters and Agreement Schedules)

KEC:lg  
property/precedent/Llc/99/01kec

cc: Honorable Claude Parrish  
Honorable Dean F. Andal  
Honorable John Chiang

Honorable Gregory J. Smith  
San Diego County Assessor

Honorable Kenneth P. Hahn  
Los Angeles County Assessor

Honorable Webster J. Guillory  
Orange County Assessor

Honorable Donald E. Williamson  
San Bernardino County Assessor

Honorable Dick Frank  
San Luis Obispo County Assessor

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