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November 7, 2006

***Re: Revenue and Taxation Code Section 62, subdivision (a)(2)***

Dear Mr. :

This is in response to your December 19, 2005 e-mail addressed to Sophia Chung, Tax Counsel IV, regarding the application of Revenue and Taxation Code section 62, subdivision (a)(2) to certain transfers of real property. For the reasons set forth below, we conclude that no reassessment of the real property will occur because the transactions you propose merely result in a change in the method of holding title to the property.

### **Background and Facts**

The facts relevant to this analysis are as follows:

1. An irrevocable trust (Trust) that has three individual beneficiaries holds title to real property. The three beneficiaries each hold one-third interest in the Trust property. The Trust forms a limited liability company (LLC) and contributes \$5,000 in cash to the LLC in exchange for a 100 percent membership interest in the LLC.
2. The Trust then forms a limited partnership (Partnership) and contributes the real property owned by the Trust to the Partnership in exchange for a 99 percent limited partnership interest. The LLC contributes \$2,500 to the Partnership in exchange for a 1 percent general partnership interest.

### **Law and Analysis**

Section 60 of the Revenue and Taxation Code<sup>1</sup> defines a "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. Change in ownership includes the transfer of any interest in real property between a legal entity or any other person. (Rev. & Tax. Code, § 61, subd. (j).) However, a change in ownership does not include any transfer between an

<sup>1</sup> All section references are to the Revenue and Taxation Code unless stated otherwise.

individual and a legal entity, such as a partnership, that results solely in a change in the method of holding title to the real property and in which the proportional ownership interests of the transferor and transferee, in each and every piece of real property transferred, remain the same after the transfer. (Rev. & Tax. Code, § 62, subd. (a)(2).) If property is transferred to a legal entity in a transaction that is excluded from change in ownership under section 62, subdivision (a)(2), then the persons holding ownership interests in that legal entity immediately after the transfer are considered to be the "original coowners." (Rev. & Tax. Code, § 64, subd. (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 coowners in one or more transactions, a change in ownership of the real property owned by the legal entity occurs, and the property that was previously excluded from change in ownership under the provisions of section 62, subdivision (a)(2), is reappraised. (*Ibid.*)

For change in ownership purposes, the present beneficiary of an irrevocable trust is considered to be the owner of the present beneficial interest in property held by the trust. (See *Reilly v. City and County of San Francisco* (August 29, 2006, Case No. A109062); see also Property Tax Rule 462.160.)

In this case, when the Trust forms the Partnership, the Trust will transfer the real property to the Partnership in exchange for a 99 percent partnership interest. The remaining 1 percent general partnership interest will be transferred to the LLC, which is owned 100 percent by the Trust. Before the transfer, the three beneficiaries of the Trust each own one-third interest in the Trust property. After the transfer, each beneficiary will own one-third interest in the property as a result of their respective one-third interest in the Partnership and their one-third membership interest in the LLC. Therefore, the transfer of the Trust property to the Partnership is proportional and no change in ownership of the property will occur. (See Rev. & Tax. Code, § 62, subd. (a)(2).)

Since the transfer of the Trust property is excluded from change in ownership pursuant to section 62, subdivision (a)(2), the three Trust beneficiaries become "original coowners." Thereafter, the real property transferred to the Partnership that was previously excluded from change in ownership will undergo a change in ownership when cumulatively more than 50 percent of the total interests in the partnership are transferred by any of the original coowners in one or more transactions. (See Rev. & Tax. Code, § 64, subd. (d).)

If the partnership was formed with the Trust holding a 99 percent partnership interest and the LLC holding a 1 percent partnership, but the Trust first contributed cash to the Partnership prior to contributing property to the Partnership, the same conclusion reached above would result. Since each of the three trust beneficiaries owns a one-third interest in the property held by the Trust prior to the transfer and, after the transfer, each would continue to own a one-third interest in the property, that is, each beneficiary would own one-third interest in the LLC -- which holds a one percent interest in the partnership, and each beneficiary would also have a one-third interest in the Trust property -- 99 percent partnership interest, the transfer would be proportional under section 62, subdivision (a)(2). Therefore, the transfer would be excluded from change in ownership reassessment as a proportional interest transfer.

Mr.

-3-

November 7, 2006

The views expressed in this letter are advisory in nature 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.

Very truly yours,

*/s/ Dana Flanagan-McBeth*

Dana Flanagan-McBeth  
Tax Counsel

DFM:ljt

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