

**STATE BOARD OF EQUALIZATION**020 N STREET, SACRAMENTO, CALIFORNIA
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Executive Director

December 20, 1990

Dear Mr. _____

This is in response to your letter of November 16, 1990, requesting advice regarding the property tax consequences of a series of proposed transactions involving the ownership of California real property.

Your letter states that the proposed transactions involve four adjoining parcels which are beneficially owned by two brothers, referred to as "A" and "B". Title to two of these properties is held through a revocable trust, referred to as "T", of which "A" and "B" are the co-trustors, co-trustees and co-beneficiaries. As co-beneficiaries, "A" and "B" each have a fifty percent beneficial interest in the trust properties. You state that the trust operates and files tax information returns as a partnership. Title to the other two properties is held through a corporation, referred to as "C", which is wholly-owned by "T".

In order to meet permit, approval and financing requirements for the joint development of the four contiguous parcels, it is necessary to consolidate title to all four properties in a single entity. For that reason, "A" and "B" propose to enter the following transactions:

- (1) "C" will create a new wholly-owned subsidiary, referred to as "S".
- (2) "S" and "T" will form a new limited partnership, referred to as the "Partnership", with "S" as the sole general partner and "T" as the sole limited partner.
- (3) "C" will contribute its two properties (subject to existing trust deeds) to the Partnership through or on behalf of "S".

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- (4) "T" will contribute its two properties (subject to existing trust deeds) to the Partnership.
- (5) The interests of "S" and "T" in the capital, profits and losses of the Partnership will be proportionate to the equities in their contributed properties. Based upon our telephone conversation, we assume that "S" will have a sixty percent interest in capital, profits and losses, while "T" will have a forty percent interest in capital, profits and losses.

According to the diagrams furnished in your letter, the results of these transactions will be that all four properties will be wholly-owned by the Partnership. "S" will be the sole general partner with a sixty percent interest. "S" will be wholly-owned by "C" which is wholly-owned by "T". "T" will be the sole limited partner of the Partnership with a forty percent interest. At all times, "A" and "B" will each retain their fifty percent beneficial interests in the property of "T".

The question, of course, is whether the proposed transactions will result in a change in ownership causing a reappraisal of some or all of the subject properties. We are in agreement with your conclusion that the proposed transactions will not constitute or give rise to a change in ownership for purposes of property tax reassessment.

Revenue and Taxation Code section 60 (all section references are to the Revenue and Taxation Code unless otherwise indicated) 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.

Section 61(i) provides that the term "change of ownership" includes the transfer of any interest in any real property between a corporation, partnership or other legal entity and a shareholder, partner or other person.

Section 62(a)(2) excludes from the term "change of ownership" any transfer between an individual or individuals and a legal entity or between legal entities, such as a co-tenancy to a partnership, a partnership to a corporation or a trust to a co-tenancy, 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. See also, Property Tax Rule 462(j)(2)(B).

Section 64(c) provides that when a corporation, partnership or other legal entity or any other person obtains a majority ownership interest in any partnership through the purchase or transfer of partnership interests, such purchase or transfer shall be a change in ownership of the property owned by the partnership in which the controlling interest is obtained. See also, Property Tax Rule 462(j)(4)(A).

The first two transactions, the creation of "S" as the subsidiary of "C" and the formation of the Partnership with "S" as general partner and "T" as limited partner, do not appear to involve the ownership or transfer of real property and, thus, those steps would not, standing alone, qualify as changes in ownership.

The contributions of the four parcels of real property to the Partnership by "C" and "S" would, however, clearly qualify as a change in ownership of those properties under subdivision (i) of section 61. An argument could also be made that there has been a change in ownership of the partnership properties under section 64(c) on the theory that "S" has obtained a controlling interest in the Partnership. This seems to be a purely technical issue, however, since the transfer of the properties to the Partnership clearly fall within the section 61(i) definition of change in ownership.

Having concluded that the Partnership's real property has undergone a change in ownership under section 61(i), and possibly section 64(c), the question remains whether these transactions may be excluded from change in ownership under section 62(a)(2). That section requires that the subject transfers result solely in a change in the method of holding title where the proportional ownership interests in the property remain the same after the transfer. It is apparent that the proportional ownership interests of "T" and "C/S" in the four parcels would be different after the transfers to the Partnership than they would be prior to such transfers. That is "C/S" had a one hundred percent interest in two parcels and "T" had a one hundred percent interest in the other two. After the transfers to the Partnership, "C/S" would have a sixty percent interest while "T" would have a forty percent interest. It could, therefore, be argued that section 62(a) does not apply to the subject transfers. It is our opinion, however, based upon our consistent past interpretations of section 62(a)(2) that proper application of this provision requires a determination of whether the proportionality of "A" and "B" as the beneficial owners of the property would remain the same after the transfers. Accordingly, since the proportional interests of "A" and "B" in each of the parcels of

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the real property transferred to the newly formed Partnership would remain the same after the transfers, section 62(a)(2) would apply to exclude such transfers from change in ownership.

The views expressed in this letter are, of course, advisory only and are not binding upon the assessor of any county. You may wish to consult the appropriate assessor in order to confirm that the described property will be assessed in a manner consistent with the conclusions stated above.

Our intention is to provide timely, courteous and helpful responses to inquiries such as yours. Suggestions that help us to accomplish this goal are appreciated.

Very truly yours,



Richard H. Ochsner
Assistant Chief Counsel

RHO:ta
2875D

cc: Mr. John W. Hagerty
Mr. Verne Walton



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December 19, 1996

FAX (619) 696-0121

Subject: Change in Ownership - Proportional Two-Step Transfer to New Corporation and New Limited Partnership under Section 62(a)(2) Does Not Trigger Step Transaction Doctrine.

Dear Mr. Prins:

This is in response to your November 22, 1996 letter requesting our opinion concerning the application of change in ownership exclusions to a transaction involving a partnership's two-step transfer of certain real property to a newly formed corporation and then to a newly formed limited partnership in exchange for proportional ownership interests in the new corporation and limited partnership.

The facts submitted for purposes of our analysis are as follows:

1. Step 1: Partnership S (PS) owns two parcels of real property designated as L1 and L2. PS will form a new legal entity, Y Corporation (Y Corp), in which PS will own 100% of the voting stock, and PS and Y Corp will then form a new legal entity, Partnership T, in which PS will own a 99% limited partnership interest and Y Corp will own a 1% general partnership interest. PS will transfer a 1% undivided interest in L2 to Y Corp.
2. Step 2: Y Corp and PS will then transfer their respective interests in L2 (1% and 99%) to Partnership T (PT).

You believe that the proposed transaction is excluded from change in ownership under the provisions of Revenue and Taxation Code Section 62(a)(2) and that the step transaction doctrine is not applicable. For the reasons hereinafter explained, we agree with your conclusion.

LAW AND ANALYSIS

As you are aware, Revenue & 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(i) which includes as a change:

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, a related provision applicable to such transfer is found in Section 62(a)(2), which excludes from change in ownership:

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 (18 California Code of Regulations 462.180) which provides specifically to partnerships in subdivision (b)(2) as follows:

(b) EXCLUSIONS:

* * *

(2) Transfers of real property between separate legal entities or by an individual(s) 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 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 interests, shall be defined as "original co-owners" for purposes of determining whether a change in ownership has occurred upon the subsequent transfer(s) of the ownership interests in the legal entity.)

One example of a transfer excluded from change in ownership set forth in subparagraph (E) of subdivision (b)(2) is similar to the proposed transaction in the instant case:

(E) A transfer of real property from Corporation X to its sole shareholder A. No change in ownership.

Based on the foregoing provisions, the transfers proposed in each of the following steps are excluded from change in ownership.

Step 1. Transfer by PS of 1% Interest in L2 to Y Corp is Excluded from Change in Ownership under Section 62(a)(2).

The transfer by PS of a 1% interest in L2 to Y Corp in exchange for all of the stock in Y Corp is excluded from change in ownership under the provisions of Section 62(a)(2). As you have indicated from the analysis of a similar transaction set forth in the Eisenlauer letter, July 31, 1995, attached, this step is merely a change PS's method of holding title to the property (L2) with the actual proportionate ownership interests in the real property remaining the same.

Step 2. Transfer by PS and Y Corp of Respective 99% and 1% Interests in L2 to PT Excluded from Change in Ownership under Section 62(a)(2).

The subsequent transfer by PS and Y Corp of their respective 99% and 1% interests in L2 to the new partnership PT, in exchange for PS's 99% limited partnership interest in PT and Y Corp's 1% general partnership interest in PT, would also be excluded from change in ownership under Section 62(a)(2) for the same reason. Only the method by which PS and Y Corp hold title to L2 has changed, and the proportional ownership interests of the PS and Y Corp in L2 will remain the same.

Step Transaction Doctrine Not Applicable

Concluding that Section 62(a)(2) excludes from change in ownership the transfers of interests in L2, raises the possibility that the two-step transfers might be considered by some to constitute a step transaction. We do not believe that the step transaction doctrine is applicable here however, because the 100% ownership interest of PS in L2 will remain the same after the transfer to PT as it was before the transfer to PT. (Prior to the transfer, PS owns L2 directly, and following the transfer, PS will own L2 indirectly, as the 100% shareholder of Y Corp and the 99% limited partner of PT.)

As stated in the attached Eisenlauer letter, in our view it is proper to "look through" the partnership or corporation to its partners or shareholders for purposes of applying Section 62(a)(2). This has been the position of the Board's staff since the enactment of Section 62(a)(2). We are aware of only one opinion that took the opposite view and that is the unpublished decision of the Court of Appeal in H.G.C. Associates v. County of Alameda (May 7, 1992) A050528, which stated that the assessor is not required to look to the ultimate ownership of a corporate transferor in determining proportionality. Because the decision is unpublished, it is not to be relied upon in any other action or proceeding. (California Rules of Court, Rule 977.) And as indicated above, there is no basis for altering our position in regard to the method of determining proportionality.

The views expressed in this letter are, of course, advisory only and are not binding upon the assessor of any county. You may wish to consult with the appropriate assessor in order to

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confirm that the described real property will be assessed in a manner consistent with the conclusions stated herein.

Our intention is to provide courteous and helpful responses to inquiries such as yours. Suggestions that help us to accomplish this objective are appreciated.

Sincerely,



Kristine Cazadd
Senior Tax Counsel

KEC:ba

Attachment: Eisenlauer Letter, 7/31/95

cc: Honorable Gregory J. Smith
San Diego County Assessor
Mr. James Speed, MIC:63
Mr. Dick Johnson, MIC:64
Ms. Jennifer Willis, MIC:71

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Executive Director

July 31, 1995

Honorable Richard P. Allen
Nevada County Assessor
950 Maidu Lane
Nevada City, CA 95959-8617

Attn: Sharon C. Wagner, Assessment Clerk

Re: Possible Step Transactions

Dear Mr. Allen:

Your letter of May 12, 1995 to the Board's Assessment Standards Division has been referred to the Legal Division for reply.

Your letter describes a situation where, on February 15, 1995, certain owners of real property conveyed fractional interests in that property totaling one percent to a corporation. The grant deed and PCORs recited that the transfers were proportional under Revenue and Taxation Code section 62. On February 16, 1995, the corporation, the grantors to the corporation and others conveyed interests in the same real property totaling 100 percent to a limited partnership. The grant deed and PCORs again recited that the transfers were proportional. A chart showing the foregoing transfers in more detail is attached hereto as Exhibit A. Your letter states that "[t]he interim transfer of 1% appears to be for the purpose of setting up the proportionality of the second transaction, thus presenting a step transaction."

As you know, step transaction issues arise when a transaction accomplished in several steps results in more favorable tax consequences than would have been the case had the transaction been accomplished in fewer steps. For example, assume that A and B transfer real property held as equal

Oliver

cotenants to Partnership X each receiving in exchange a 49 percent interest in Partnership X and with C receiving a two percent interest in Partnership X. Such a transaction would result in a 100 percent change in ownership of the property of Partnership X. (See Property Tax Rule 462.180, subdivision (b) (2) (B).) If first, however, A and B each deeded a one percent interest in the real property to C and A, B, and C then transferred their interests in the real property to Partnership X proportionately, there would be a change in ownership with respect to only two percent of the real property (assuming the de minimus rule is inapplicable) unless the step transaction doctrine is applicable.

If instead, A and B first each transferred a one percent interest in their real property to Corporation Y proportionately in exchange for all of the stock of Corporation Y such transfers would be excluded from change in ownership as simply a change in the method of holding title with the proportional ownership interests in the real property remaining the same. (Rev. & Tax. Code §62, subd. (a) (2).)

Then, if A, B, and Corporation Y transferred their respective interests in the real property to Partnership X with A and B each receiving a 49 percent interest in Partnership X as limited partners and Corporation Y receiving a two percent interest in Partnership X as the general partner such transfers would be excluded for the same reason.

In our view, the latter transaction would not constitute a step transaction because the proportional ownership interests of A and B in the real property would remain the same after the transfer to Partnership X as they were prior to the transfer to Corporation Y, i.e., fifty percent in A and fifty percent in B.

Assuming the transfers in this case are proportional, as claimed, they appear to be within the latter category discussed above and thus, in our view, would not constitute a step transaction. This conclusion, of course, depends upon the validity of our view that it is appropriate to "look through" the corporation to its shareholders for purposes of applying Revenue and Taxation Code section 62, subdivision (a) (2). We have consistently held this view since that provision was enacted. Enclosed for your information, however, is a copy of the unpublished opinion of the Court of Appeal in *H.G.C. Associates v. County of Alameda* (May 7, 1992) A050528 in which the court took the opposite view and held that section 62, subdivision

July 31, 1995

(a) (2) does not require the assessor to look to the ultimate ownership of a corporate transferor in determining proportionality.

Under Rule 977 of the California Rules of Court, such unpublished opinions are not to be "cited or relied upon by a court or a party in any other action or proceeding" subject to exceptions not here relevant. For that reason and because we don't agree with the decision, we have not changed our position that it is permissible to "look through" a corporation or other entity for purposes of applying section 62, subdivision (a) (2).

If, however, the *H.G.C. Associates* case were considered to be an accurate interpretation of section 62, subdivision (a) (2), a step transaction issue would be raised by the transfers you have described in this case. In determining whether the step transaction doctrine is applicable by an assessor in a given case, see the Board's letter to County Assessors dated October 14, 1992 (No. 92/69) a copy of which is enclosed.

Sincerely,



Eric Eisenlauer
Senior Staff Counsel

EFE:ba
Enclosures

cc: Mr. John Hagerty - MIC:63
Mr. Dick Johnson - MIC:64
Ms. Jennifer Willis - MIC:70