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May 28, 2002

JAMES E. SPEED
Executive Director

RE: Change in Ownership Upon Dissolution of a Limited Partnership

Dear Mr. _____,

This is in reply to your letter of April 11, 2002 in which you request that we reconsider the analysis and conclusions set forth in the opinion letter dated April 11, 1997 which concerned the application of the change in ownership provisions to the dissolution of a partnership upon the death of a partner. As you state in your letter, our analyses and conclusions were based on the provisions of the Uniform Partnership Act which has been repealed and you request that we analyze the same facts and questions addressed in that previous letter by considering the California Revised Limited Partnership Act (RLPA), Corporations Code sections 15611 through 15723, and opine as to whether the conclusions would be different under the RLPA. However, in our subsequent phone conversation on May 23, 2002, you requested that our opinion address only the issue of whether under the RLPA, as applied to the relevant facts of that letter involving the death of a general partner of a limited partnership, would result in a change in ownership of the limited partnership's property. As you requested, our response is limited to an analysis of that issue and our conclusions thereon.

As set forth below, when a limited partnership dissolves upon the death of a partner (whether general or limited), but the remaining partner or partners carry on the partnership's business in the form of a new partnership, there is a change in ownership of the partnership's real property. However, no change in ownership results, when the partner dies, the limited partnership is continued pursuant to the provisions of the Corporations Code governing dissolution of a limited partnership.

Relevant Facts

Two individuals, A and B, form a limited partnership ("LP") in which each owns a 50 percent capital and profits' interest. A is the general partner and B is the limited partner. The partnership agreement does not include a provision for continuation of the LP upon the death of the general partner. The partnership acquires and holds real property in the name of the partnership. A dies and his 50 percent partnership interest passes to his son, C. B decides to continue the business of the partnership and admit C as the new general partner. The partnership agreement is amended to add C as the new general partner.

Law and Analysis

The Revised Limited Partnership Act (Corporations Code sections 15611 through 15723) are the statutory provisions governing the formation, operation and dissolution of limited partnerships. With respect to the general partner, section 15642 provides that, in the case of a general partner who is an individual, he or she ceases to be a general partner of a limited partnership upon his or her death. Thus, upon death A's ceased to be a general partner. When a general partner to be a general partner, Corporations Code section 15681 provides in subdivision (c) that, unless the partnership agreement provides otherwise or absent certain conditions discussed below, the limited partnership is dissolved and its affairs shall be wound up.

Under California property tax law, transfers of interests in real property, including transfers of interests in legal entities holding real property, occur upon the death of the owner. Specifically, Property Tax Rule 462.260, subsection (c) states that the date of change in ownership of real property for reappraisal purposes is the date of death of the owner. In adopting this provision of the Rule, the Board of Equalization relied on California Probate Code section 7000, which expressly states:

Subject to Section 7001, title to a decedent's property passes on the decedent's death to the person to whom it is devised in the decedent's will or, in the absence of such a devise, the decedent's heirs as prescribed in the laws governing intestate succession.

Thus, at A's death, his 50 percent partnership interest immediately transferred to his son, C. Although he did not thereby succeed to legal title as a partner, he did acquire beneficial ownership of A's 50 percent capital and profits interest. If the partnership dissolved as a result of A's death, B remained as the surviving partner solely for the purpose of winding up the dissolved partnership and to account to C for A's share.

When a partnership undergoes a technical dissolution by the death of a partner, it retains its legal existence as an entity for the limited purpose of winding up. As a result, A's and C's interests in the partnership's property are vested upon dissolution, but they do not become possessory until actual liquidation and distribution of the partnership's property, including real property. During the process of winding up, the surviving partner continues to hold his 50 percent partnership interest and the deceased partner's 50 percent partnership interest transfers to that partner's heir. Generally, the transfer of partnership interests does not result in a change in ownership of real property owned by the partnership pursuant to Revenue and Taxation Code section 64, subdivision (a) which provides:

(a) Except as provided in subdivision (h) of Section 61 and subdivisions (c) and (d) of this section, the purchase or transfer of ownership interests in legal entities, such as corporate stock or partnership or limited liability company interests, shall not be deemed to constitute a transfer of the real property of the legal entity. This subdivision is applicable to the purchase or transfer of ownership interests in a partnership without regard to whether it is a continuing or dissolved partnership.

Since the exceptions provided in Section 61(h) and Section 64(c) and (d) are not applicable, the transfer of A's 50 percent partnership interest to C does not result in a change in ownership.

Effect of Dissolution

If the partnership was dissolved by A's death, then the subsequent agreement by B and C to become partners effectively formed a new partnership, either by (a) transferring the dissolved partnership's real property to the new partnership, or (b) by distributing the real property from the dissolved partnership to themselves and then transferring the real property to the new partnership. The transfer or transfers from the dissolving partnership with B as the remaining partner, to the new partnership with B and C as partners, will result in a change in ownership of the real property. Board Property Tax Rule 462.180 (Title 18, California Code of Regulations section 462.180) provides in relevant part that

- (a) The transfer of any interest in real property to a corporation, partnership, or other legal entity is a change in ownership of the real property interest transferred.

Thus, the transfer from the dissolving partnership to the new partnership would be a change in ownership of the real property.

The transfer from the dissolved partnership to B as the former partner and to C as A's heir would also be a change in ownership under section 61(i). Section 61(i) provides

Except as is otherwise provided in Section 62, change in ownership, as defined in Section 60, includes, but is not limited to:

* * *

- (i) 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 the result of the transfers from the dissolved partnership, the real property would pass from the partnership to B and C as individuals unless an exclusion applies.

In this regard, Rev. and Tax. Code section 62, subdivision (a)(2) excludes from change in ownership, legal entity-to-individual transfers of the same proportional ownership interests in the real property. Specifically, subdivision (a)(2) excludes from change in ownership

- (a)(2) 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.

Thus, if the dissolving partnership transfers the partnership real property to B and C in direct proportion to their partnership interests, i.e., 50% to each, the transfers would be excluded from change in ownership under section 62(a)(2).

After distribution of the property to B and C, they would contribute their real property interests to the new partnership and obtain partnership interests. If each transfers his 50% real property interest to the new partnership and receives in return a 50% partnership interest, proportionality would be maintained, thus, the transfers would be excluded under section 62, subdivision (a)(2). Notwithstanding the proportionality of such transfers and applicability of the exclusion, in our view, such a transaction would be subject to the application of the step transaction doctrine and would result in a change in ownership.

The "step transaction doctrine" has been applied to real property transfers when unnecessary steps are taken merely to circumvent the intent of the change in ownership statutes; in which case, the "substance of the transaction, rather than the form" will determine if a change in ownership has actually occurred. *Shuwa Investment Corp. v. County of Los Angeles* (1991) 1 Cal.App.4th 1635. To determine whether particular circumstances warrant "stepping" together multiple transactions to arrive at the substance of a transaction, courts have developed three principal tests - end result, interdependence and binding commitment.

In this instance, it appears that the "end result test" compels the conclusion that the two transfers should be stepped together. "Under the 'end result test', purportedly separate transactions will be amalgamated with a single transaction when it appears that they were really component parts of a single transaction intended from the outset to be taken for the purpose of reaching the ultimate result." *Shuwa Investment Corp. v. County of Los Angeles* (1991) 1 Cal.App.4th 1635, 1650. Here it appears the two steps were really component parts of a single transaction. The ultimate result intended from the outset was for B and C to become partners in the new partnership.

Exceptions to Partnership Dissolution

Notwithstanding the general provision for dissolution set forth in Corporations Code section 15681, subdivision (c) sets forth two conditions for continuation of the partnership, which if satisfied, would not result in a change in ownership. Those conditions are as follows:

- (1) at the time there is at least one other general partner and the remaining general partner, or all the general partners if more than one remains, continue the business of the limited partnership, or
- (2) at the time there is no remaining general partner and a majority in interest of the limited partners or the greater interest provided in the partnership agreement agree in writing to continue the

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business of the limited partnership and, within six months after the last remaining general partner has ceased to be a general partner, admit one or more general partners.

In this case, the condition stated in subparagraph (1) is inapplicable because no general partner remained; however, under subparagraph (2) B may elect to continue the partnership as he constitutes a majority in interest of the limited partners. Thus, in this case, the partnership would not dissolve if B elected in writing to continue the business of the LP and within six months after A's death admits C or some other person as a general partner. In that event, there has been no dissolution of the partnership and, thus, no transfer of the real property which would result in a change in ownership under section 64(a), 50 percent of the capital and profits interests in the same LP could transfer to C or another person.

The views expressed in this letter are only advisory in nature; 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/ Lou Ambrose

Lou Ambrose
Supervising Tax Counsel (Acting)

LA:tr
prop/prec/prtnrshp/02/04lou

cc: Mr. David Gau, MIC:63
Chief - PPSD, MIC:64
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