

Memorandum

To : Mr. Verne Walton

Date : May 3, 1989

From : Eric F. Eisenlauer

Eric F. Eisenlauer

Subject : Change in Ownership - Partnership Interest

This is in response to your memorandum of April 5, 1989, to Mr. Richard Ochsner in which you request our opinion as to whether a change in ownership would occur under either of the following two scenarios:

1. Partnership One owns the Property. "A" owns 50 percent of Partnership One, as a limited partner. Partnership Two owns the other 50 percent of Partnership One, as the general partner. Partnership Three owns 25 percent of Partnership Two, as a limited partner. If "A" acquires an 8.5 percent limited partnership interest in Partnership Two from Partnership Three, has a change of ownership occurred for purposes of determining the propriety of reassessing the Property? "A" would have a 50 percent direct limited partnership interest in the Property, and another approximately 1.2 percent limited partnership interest, indirectly. No actual change of control is possible due to the fact that the interest which is proposed to be acquired is a limited partnership interest, and is an interest in a partnership where the other 98.8 percent is owned and controlled by unaffiliated, unrelated parties, with 75 percent held by a single general partner. "A" would ultimately be distributed more than 50 percent of the profits from the Property, but would not necessarily own a corresponding amount of the capital of the partnership.

Revenue and Taxation Code (all statutory references are to the Revenue and Taxation Code unless otherwise indicated) section 60 defines "change in ownership" to mean "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 64(a) provides in relevant part that "[e]xcept as provided in subdivision . . . (c) . . . of this section, the purchase or transfer of ownership interests in legal entities, such as . . . partnership interests, shall not be deemed to constitute a transfer of the real property of the legal entity."

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Section 64(c) provides in relevant part that "[w]hen a corporation, partnership, other legal entity or any other person obtains control as defined in Section 25105, in any corporation, or obtains a majority ownership interest in any partnership . . . through the purchase or transfer of corporate stock, [or] partnership interest . . . such purchase or transfer . . . shall be a change of ownership of property owned by the corporation, [or] partnership . . . in which the controlling interest is obtained."

Section 25105 provides that "[d]irect or indirect ownership or control of more than 50 percent of the voting stock . . . shall constitute ownership or control. . . ."

The Board has interpreted the foregoing provisions in Property Tax Rule 462(j) which provides in relevant part that "[¶] (3) . . . [e]xcept as is otherwise provided in subdivision (4), the purchase or transfer of corporate stock, partnership shares, or ownership interests in other legal entities is not a change in ownership of the real property of the legal entity." Subdivision (4)(A) provides an exception to the foregoing rule "[w]hen any corporation, partnership, other legal entity or any person: (i) obtains direct or indirect ownership or control of more than 50 percent of the voting stock in any corporation which is not a member of the same affiliated group of corporation . . ., or (ii) obtains direct or indirect ownership of more than 50 percent of the total interest in both partnership capital and profits . . . [¶] Upon the acquisition of such direct or indirect ownership or control, all of the property owned directly or indirectly by the acquired legal entity is deemed to have undergone a change in ownership."

Under the foregoing provisions, it has consistently been our position that to attribute indirect ownership of property which is directly owned by either a general or limited partnership to a person or entity requires ownership of more than 50 percent of the capital and profits of the partnership by the person or entity. Thus, before a change in ownership of the property of Partnership One can occur here under section 64(c), "A" must obtain direct or indirect ownership of more than 50 percent of the partnership interest in Partnership One. Since "A" directly owns 50 percent of Partnership One and Partnership Two owns the other 50 percent, "A" would either have to obtain an interest in Partnership One directly from Partnership Two or obtain an interest in Partnership One indirectly by acquiring more than a 50 percent interest in the capital and profits of Partnership Two in order to trigger section 64(c). Since the only acquisition intended by "A" is an 8.5 percent limited partnership interest in Partnership Two, no change in ownership would occur under section 64(c) and the acquisition would be excluded under section 64(a).

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2. Assume the same ownership structure, but instead of "A" acquiring an 8.5 percent limited partnership interest in Partnership Two, "A" is given an assignment of 8.5 percent of the profits and losses of Partnership Two, but no partnership interest whatsoever, and none of the rights, duties, or obligations of a partner in Partnership Two. Has a change in ownership occurred?

Since "A" would be acquiring less under this scenario than under No. 1 above, no change in ownership would occur as a result of such acquisition.

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cc: Mr. John W. Hagerty
Mr. Robert H. Gustafson



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Executive Director

January 22, 1999

, Senior Manager

In Re: Change in Control - Direct and Indirect Ownership of Partnership Interests - Attribution.

Dear Mr. :

This is in response to your letter of August 8, 1998, in which you requested our opinion concerning the application of the change in ownership provisions under Revenue and Taxation Code Section 64 in transactions that may result in transfers of direct and indirect ownership in partnership capital and profits interests. Your hypothetical fact patterns focus on the issue of "control" of a partnership where some of the partners in the partnership are other partnerships or corporations. Also at issue in each fact pattern is whether there is a basis for the attribution of stock ownership or partnership capital and profits interests to an individual or entity. We apologize for the time delay in responding to your request; unfortunately prior commitments took longer to complete than originally anticipated.

In setting forth the answers to your questions, it is important to note the statutory basis for a "change in control" under Section 64 (c) and its regulatory implementation under Property Tax Rule 462.180(d). The reappraisal of real property owned by a partnership, corporation, or other legal entity occurs under Section 64(c) when any person or entity obtains "control," through direct or indirect ownership or control of more than 50 percent of the voting stock of any corporation, or obtains a majority interest in any partnership, limited liability company or other legal entity through the purchase or transfer of corporate stock, partnership, or ownership interests in other legal entities.

"Control" is further defined and applied to corporations and partnerships specifically in Rule 462.180(c) and (d), which states in part:

(c) Except as is otherwise provided in subdivision (d), the purchase or transfer of corporate stock, partnership shares, or ownership interests in other legal entities is not a change in ownership of the real property of the legal entity.

(d) Exceptions:

(1) When any corporation, partnership, other legal entity or any person:

(A) obtains direct or indirect ownership or control of more than 50 percent of the voting stock in any corporation which is not a member of the same affiliated group of corporations as described in (b)(1), or

(B) obtains direct or indirect ownership of more than 50 percent of the total interest in both partnership capital and profits,

* * *

Upon the acquisition of such direct or indirect ownership or control, all of the property owned directly or indirectly by the acquired legal entity is deemed to have undergone a change in ownership.

Under the foregoing, it has consistently been our position that the definition of "control" provides a basis for attribution of stock or partnership capital and profits interests only when one individual or entity acquires a controlling interest in a corporation, partnership, or other legal entity for purposes of Section 64(c). (See Annotation No. 220.0111, enclosed.) Therefore, to attribute to an individual or entity, indirect ownership of property which is directly owned by a general or limited partnership requires ownership by that individual or entity of more than 50 percent of the capital and profits interests in the partnership. (See Annotation Nos. 220.0525 and 220.0501, enclosed.) The fact patterns you have submitted for purposes of our analysis illustrate the application of this principle of property tax law and are addressed accordingly.

Fact Pattern A

P1 is a partnership which owns real property in California. P1 is owned 40 percent by A, an individual, 50 percent by P2, a partnership, and 10 percent by C1, a corporation.

1. Is there a change in control of P1 resulting in a change in ownership of the real property owned by P1, if A acquires 50 percent of the capital and profits of P2?

Answer: No.

There is a change in ownership of the real property owned by P1 only if A obtains direct or indirect ownership or control of more than 50 percent of the total interests in both the partnership capital and profits in P1. Under the facts posited in this question, A *directly* owns only 40 percent of P1 and acquires a 50 percent capital and profits interest in P2. Upon such acquisition, A would not own a controlling interest in P2, and therefore, *indirectly* owns no interest in P1 through his 50 percent capital and profits interest in P2. No change in control of P1 would occur. In order for A

to acquire an *indirect* interest in P1 attributed to him through P2, he must own more than a 50 percent *direct* interest in P2.

2. Is there a change in control of P1 resulting in a change in ownership of its real property, if A acquires 51 percent of the capital and profits of P2?

Answer: Yes.

As discussed in regard to Section 64 (c) and Rule 462.180 (d)(1)(B) above, the capital and profits interests in a partnership may be attributed to the individual or entity owning a controlling interest in that partnership for purposes of determining a change in control. In applying this principle, if A obtains more than a 50 percent interest in P2, resulting in A acquiring "control" of P2, then A's (51 percent) direct interest in P2 would be attributed to him for purposes of determining a change in ownership in P1. Thus, when A acquires 51 percent of the capital and profits interests in P2, there is a change in control of P2. The result is that the 50 percent capital and profits interest which P2 owns in P1 would then be attributed to A. Since A already owns 40 percent of P1 directly, and A's acquisition of control of P2 is regarded as an indirect transfer to him of P2's entire 50 percent in P1, A would own 90 percent of the total capital and profits interests in P1. The result is a change in control of P1 under Section 64 (c). In calculating the 90 percent, A's *direct* 40 percent interest in P1 is added together with A's *indirect* 50 percent interest in P1 (attributed through A's "control" of P2). Upon the change in control of P1, all of the real property held by P1 would be subject to reappraisal.

3. Is there a change in control of P1 resulting in a change in ownership of its real property, if C2, a corporation, acquires 51 percent of the capital and profits interests of P2 and 51 percent of the voting stock of C1?

Answer: Yes.

Per the narrative explanation stated above, the capital and profits interests in a partnership may be attributed to the individual or entity owning a controlling interest in that partnership for purposes of Section 64 (c) and Rule 462.180 (d)(1)(B). If, an unrelated corporation, C2, acquires 51 percent of the capital and profits interests in P2, there is a change in control of P2. The result is that the 50 percent capital and profits interest which P2 owns in P1 would then be attributed to C2. Likewise, if C2 acquires 51 percent of the voting stock of C1, there is a change in control of C1. The result is that the 10 percent capital and profits interest which C1 owns in P1 would be attributed to C2. Therefore, following its acquisition of control of C1, C2 would have acquired control of P1. That is, since C2 acquired 50 percent of P1 indirectly through its control of P2 in the first step, and 10 percent of P1 indirectly through its control of C1 in the second step, C2 has *indirectly* obtained ownership of 60 percent of the capital and profits interests in P1. The result is a change in control of P1 under Section 64 (c). Upon the change in control of P1, all of the real property held by P1 would be subject to reappraisal.

Fact Pattern B

C1, a corporation, owns a 50 percent general partnership interest in the capital and profits of P1, as does C2, also a corporation. P1 owns real property in California.

1. Is there a change in control of P1 resulting in a change in ownership of the real property owned by P1, if C3, another corporation, acquires 51 percent of the voting stock of both C1 and C2?

Answer: Yes.

As set forth above, capital and profits interests in a partnership may be attributed to an entity owning a controlling interest in that partnership. If, under Fact Pattern B, an unrelated corporation, C3, acquires 51 percent of the voting stock of C1 and 51 percent of the voting stock of C2, there is a change in control of both C1 and C2. The result is that the 50 percent capital and profits interest in P1 owned by C1, and the 50 percent capital and profits interest in P1 owned by C2 would be attributed to C3. Therefore, following its acquisition of a controlling interest in the voting stock of C1 and C2, C3 would have acquired total control of P1 under Section 64 (c). In effect, C3 has indirectly obtained ownership and control of 100 percent of the capital and profits interests in P1, and all of P1's real its property would be subject to reappraisal.

2. Is there a change in control of P1 resulting in a change in ownership of the real property owned by P1, if C3 acquires 100 percent of the voting stock of both C1 and C2?

Answer: Yes.

The reason is the same as in the narrative above under the first question to Fact Pattern B, except that C3 will own 100 percent, rather than 51 percent, of the voting stock of both C1 and C2 .

Fact Pattern C

P1, a general partnership which owns California real property, owns a 51 percent general partner interest in the capital and profits of P2, a general partnership which owns California real property, and P2 owns 51 percent general partner interest in the capital and profits of P3, a general partnership which owns California real property.

1. Is there a change in control of either P1, P2, and/or P3 resulting in a change in ownership and reappraisal of their respective real properties, if C1, a corporation, acquires 51 percent of the capital and profits of P1?

Answer: Yes.

As explained previously, the capital and profits interests in a partnership may be attributed to the entity owning a controlling interest in that partnership for purposes of Section 64 (c) and Rule 462.180 (d)(1)(B). If, under Fact Pattern C, C1 acquires 51 percent of the capital and profits interests in P1, there is a change in control of P1 resulting in a change in ownership of the real property owned by P1. A further result is that the 51 percent capital and profits interest which P1 owns in P2 would then be attributed to C1. This in turn, triggers the attribution of the 51 percent capital and profits interest which P2 owns in P3 to C1. Because of the attribution of interests in P1, P2 and P3 to C1, C1 would have acquired ownership and control of each partnership under Section 64 (c). In effect, C1 has acquired 51 percent of P1 directly and 51 percent of both P2 and P3 *indirectly* through its control of P1 in the first step. The result is a change in control of P1, P2, and P3, triggering reappraisal of all of the real property held by each.

2. Is there a change in control of either P1, P2, and/or P3 resulting in a change in ownership and reappraisal of their respective real properties, if S1 and S2, which are 100 percent subsidiaries of C1, each acquire 50 percent of the capital and profits of P1?

Answer: Yes.

The reason is the same as in the narrative above under the first question to Fact Pattern C, except that S1 and S2 will acquire 100 percent of the capital and profits interests in P1, which interests will be attributed to C1, since they are wholly owned subsidiaries of C1.

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,



Kristine Cazadd
Senior Tax Counsel

KEC:lg

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Attachments: Annotation Nos. 220.0501, 220.0111, and 220.0525

cc: Honorable John N. Scott
Alameda County Assessor
Mr. Richard Karlsson, Assistant Alameda County Counsel

Mr. Richard Johnson, MIC:63
Mr. David Gau, MIC:64
Ms. Jennifer Willis, MIC:70