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March 13, 2006

Honorable Tom J. Bordonaro, Jr.
San Luis Obispo County Assessor
County Government Center, Rm: 100
San Luis Obispo, CA 93408-2070

Attn:

Re: Change In Ownership – Proportional Interest Transfer

Dear Ms. :

This is in response to your October 14, 2005 e-mail to Sophia Chung, Tax Counsel IV, requesting our opinion as to whether a transfer of commercial property by an individual to a limited partnership is excluded from change in ownership under Revenue and Taxation Code[1] section 62, subdivision (a)(2). Based on the facts you provided, the transfer does not qualify for the exclusion and is a reassessable change in ownership.

Factual Background

You state in your e-mail that on December 24, 2002, 74.15 percent of a piece of commercial property was purchased by Paso Robles LP (Paso Robles) and 25.85 percent was purchased by O (O). On December 22, 2004, O granted his interest in the commercial property to Paso Robles in exchange for interests in that partnership. The percentage of the partnership interest transferred to O was not stated, but there was a statement on the deed that stated that it was a "Transfer to Partnership in exchange for same proportional interest." Subsequent inquiries revealed that O received a 40 percent interest in Paso Robles in exchange for his 25.85 percent interest in the commercial property. You advised the taxpayer that this transfer would be reassessable because it was not a proportional ownership interest transfer; however, the taxpayer disagreed and sent additional information, including the First Amendment to the limited partnership agreement. It states in pertinent part:

> O ("O "), an unmarried man, who owns an undivided 25.85% interest in the Property on which the Partnership's Facilities are situated, has offered to contribute its [sic] undivided interest in the Property to the Partnership in exchange for an equivalent interest in the Partnership, based on the percentage that the value of his interest in the Property, bears investment of the partnership in the Property [sic] bears to the investment of all of the co-owners in the Property.

[1]All further statutory references are to the Revenue and Taxation Code unless otherwise specified

> C. The General Partner has agreed to accept such offer and to admit O as an additional limited partner in exchange for the contribution to the Partnership by O of his undivided interest in the Property.
>
> D. The undivided interest in the property owned by O is valued at $1,200,000 and the equivalent partnership interest in the Partnership is therefore an 40% partnership interest.

Furthermore, in a letter accompanying the copy of the amendment to the partnership agreement, the General Partner stated:

> As you can see, Thomas O contributed his co-ownership equity for an equivalent interest in our partnership. The reason the grant deed shows a different original percentage for Mr. O is due to 1031 exchange rules which do not allow exchanging real property for "goodwill" and/or personal property. A part of the original purchase included those two elements. They are not "like kind" under IRC regulations.

Legal Analysis

Section 60 provides that a change in ownership means a transfer of: (1) a present interest in real property; (2) including the beneficial use thereof; (3) the value of which is substantially equal to the value of the fee interest. Subdivision (a)(2) of section 62 provides for an exclusion from the definition of a change in ownership for proportional interest transfers between a legal entity and individuals. It states in pertinent part that the following is not a change in ownership:

> Any transfer between an individual . . . and a legal entity . . . that 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 . . . in each and every piece of real property transferred, remain the same after the transfer. [Emphasis added.]

Although the term "ownership interests" is not defined in law or regulation, it has been interpreted to mean the total interest in both partnership capital and profits. (See Property Tax Annotation 220.0385, enclosed.)

In this case, it appears that Paso Robles attempted to equalize the *value* of the land contributed with the *value* of the partnership interest received, as evidenced in Paragraph B of the First Amendment to the limited partnership agreement. However, that is not the standard for exclusion found at section 62, subdivision (a)(2). That section requires that the *proportional ownership interests* in the property and the legal entity remain the same. Here, in exchange for his 25.85 percent interest in the real property, O received a 40 percent interest in the limited partnership. Although the value of the real property interest and the value of the partnership interest may both be $1.2 million dollars, the percentage ownership interests are different. Before the transfer, O 's ownership interest in the capital and profits of the real property was 25.85 percent but after the transfer his ownership interest in the capital and profits of the partnership is 40 percent. Such an exchange does not meet the requirements of section 62, subdivision (a)(2).

The managing partner asserts that the grant deed shows a different original percentage for O due to 1031 exchange rules which do not allow exchanging real property for "goodwill" and/or personal property. Even if this is true, it does not affect the outcome. The grant deed shows O owning a 25.85 percent interest in the property. How that percentage was originally calculated is irrelevant. Unless that percentage is the same percentage of Paso Robles received back by O , the section 62, subdivision (a)(2) exclusion does not apply.

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

Sincerely,

Richard S. Moon
Tax Counsel

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cc: Mr. David Gau, MIC:63
Mr. Dean Kinnee, MIC:64
Ms. Mickie Stuckey, MIC:62
Mr. Todd Gilman, MIC:70
Mr. Robert Lambert, MIC:82