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February 5, 2015

**Re: Change of Ownership – Reassessment  
 Assignment No.: 14-364**

Dear Mr. Bender:

This is in response to your October 20, 2014 letter to Assistant Chief Counsel Robert Tucker, in which you requested our opinion as to whether certain proposed transactions would trigger a reassessment of real property owned by a legal entity. As explained below, it is our opinion that none of the transactions would result in reassessment of the real property.

**Factual Background**

In your letter, you stated that \_\_\_\_\_ Benefit Fund (BF), a multi-employer pension fund, formed \_\_\_\_\_ Associates, LLC (Taxpayer), a single member LLC in January 2011, to take title to the property at \_\_\_\_\_, CA.<sup>1</sup> BF engaged \_\_\_\_\_ Fund, Inc. through an affiliate, E \_\_\_\_\_ LLC (E \_\_\_\_\_), to develop the property. E \_\_\_\_\_ made a cash investment in Taxpayer in exchange for a 5 percent interest in Taxpayer.

Taxpayer has been approached by an unrelated investor (Investor) interested in purchasing a 49 percent interest in Taxpayer. Because Investor will only invest in real property through a "real estate investment trust" (REIT), Taxpayer proposes to make an election with the Internal Revenue Service (IRS) to be treated as a REIT for federal income tax purposes.

Next, BF and E \_\_\_\_\_ will sell 49 percent of their combined equity in Taxpayer to Investor, and Taxpayer (as a REIT) will issue shares to 100 unrelated shareholders, with the combined equity interest in the shares less than 1 percent.

Finally, the three co-owners (BF, E \_\_\_\_\_, and Investor) will transfer their interest in Taxpayer to a newly formed limited liability company (Parent LLC) to be taxed as a partnership.

<sup>1</sup> We express no opinion with respect to any transactions involving the property prior to its transfer to Taxpayer in January 2011. We also assume, without expressing an opinion, that BF is not an "original co-owner" within the meaning of Revenue and Taxation Code section 64, subdivision (d) with respect to Taxpayer.

Unrelated to the possible investment by Investor, E's profit allocation may shift up or down over time if it meets development-related performance criteria or if it is paid in advance for its profit share. You ask us to assume that the performance criteria will be met, and you state that there will be no capital shift within the meaning of Subchapter K of the Internal Revenue Code, and E's capital account will not be increased; nor will BF's or Investor's capital accounts be decreased. Finally, you state that any increase in E's allocable profits will only reduce profits otherwise due BF, and will not affect Investor's 49 percent ownership interest.

If the first performance criteria are met, the profit allocation in Taxpayer through Parent LLC would be:

BF: 44.75%	E : 6.25%	Investor: 49%
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If E exercises its option to sell the increased profit share earned after meeting the first performance criteria, then the profit allocation would be:

BF: 48.5%	E : 2.5%	Investor: 49%
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If the second and final performance criteria are met, the profit allocation would be:

BF: 43.5%	E : 7.5%	Investor: 49%
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### **Law and Analysis**

Article XIII A, section 2 of the California Constitution requires the reassessment of real property upon a "change in ownership," unless an exclusion from change in ownership applies. A change in ownership is defined in Revenue and Taxation Code section<sup>2</sup> 60 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 64, subdivision (a) provides that the purchase or transfer of ownership interests in legal entities does not constitute a transfer of the legal entity's real property. One exception to this rule is provided in section 64, subdivision (c)(1), and Property Tax Rule<sup>3</sup> (Rule) 462.180, subdivision (d)(1), which provide that when a legal entity or other person obtains control through direct or indirect ownership or control of more than 50 percent of a corporation's voting stock, or obtains a majority ownership interest in any partnership, limited liability company, or other legal entity, through the purchase or transfer of that corporate stock or other interest, there is a change in ownership of the real property owned by that corporation or other legal entity in which the controlling interest is obtained. For limited liability companies, the degree of ownership is determined by the direct or indirect ownership of the interests in the capital and profits.<sup>4</sup>

<sup>2</sup> All "section" references are to the California Revenue and Taxation Code, unless otherwise indicated.

<sup>3</sup> Cal. Code Regs., tit. 18, § 462.180. All Rule references are sections to title 18 of the California Code of Regulations.

<sup>4</sup> Rule 462.180, subd. (d)(1)(B).

Rule 462.180, subdivision (d)(4) provides that transfers of legal entity interests that result solely in a change in the method of holding title, and in which proportional ownership interests in all real property represented by the transferred interests remain the same after the transfer, do not constitute a change in ownership. Whenever a transfer of ownership interests in a legal entity (transferred entity) is excluded from change in ownership under Rule 462.180, subdivision (d)(4), immediately after the transfer the holders of the interests in the legal entity to which the interests were transferred (transferee entity) become "original co-owners" with respect to the legal entity ownership interests of the transferee entity for purposes of determining the change in ownership consequences of any subsequent transfers of transferee entity interests.<sup>5</sup> Subsequently, whenever cumulatively more than 50 percent of the total original co-owner interests in the transferee entity are transferred by any of the original co-owners in one or more transactions, a change in ownership of that real property that was previously excluded from change in ownership occurs.<sup>6</sup>

#### Transaction 1: Conversion of Taxpayer into a REIT

In this step, Taxpayer intends to make an election with the IRS to be treated as a REIT. A REIT is defined in Internal Revenue Code section 856 as an entity that would be taxable as a domestic corporation (but for its treatment as a REIT) for federal income tax purposes and that meets a number of organizational, operational, and distribution requirements. A REIT is eligible for certain preferential federal tax treatment. The entity must file a form with the IRS to elect to be treated as REIT.<sup>7</sup>

Since a REIT election is only a tax treatment election and Taxpayer will continue to hold the Property after the REIT election, there is no formation of any new entity, transfer of any entity interest or real property, and thus the REIT election will not result in a change in ownership of any real property owned by Taxpayer.

#### Transaction 2: Sale of Interest in Taxpayer to Investor/Admission of 100 REIT Shareholders

One of the requirements to be taxed as a REIT is that, beginning with its second taxable year, the entity must have at least 100 different shareholders, and 5 or fewer individuals cannot own more than 50 percent of the value of the REIT's stock during the last half of its taxable year.<sup>8</sup>

Since no one person or legal entity will obtain more than a 50 percent ownership interest in Taxpayer as a result of this proposed transaction, there would be no change in control of Taxpayer.<sup>9</sup> Therefore, neither the sale of a 49 percent interest in Taxpayer to Investor or the transfer of less than a 1 percent interest in Taxpayer to 100 new shareholders will cause a change in ownership of the real property owned by Taxpayer.<sup>10</sup> In addition, since BF is not an original co-owner in Taxpayer, section 64, subdivision (d) does not apply.

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<sup>5</sup> Rule 462.180, Example 10.

<sup>6</sup> Rev. & Tax. Code, § 64, subd. (d); Rule 462.180, subd. (d)(2).

<sup>7</sup> See Internal Revenue Code, § 856 et seq.

<sup>8</sup> *Id.*

<sup>9</sup> Rev. & Tax. Code, § 64, subd. (c)(1).

<sup>10</sup> See Rev. & Tax. Code, § 64, subd. (a).

Transaction 3: Transfer of Legal Entity Interest to a New Holding Company

All three members (BF, E , and Investor) of Taxpayer will transfer their membership interest in Taxpayer to a newly formed limited liability company (Parent LLC). After the transfer, Parent LLC will own 100 percent of Taxpayer. This is a change in control of Taxpayer pursuant to section 64, subdivision (c)(1). However, if the interest in Taxpayer held directly by each of the three members prior to the transaction are identical to the interest in Taxpayer held by the members indirectly through their ownership of Parent LLC after the transaction, this transaction qualifies for the proportional ownership interest transfer exclusion under section 62, subdivision (a)(2) and Rule 462.180, subdivision (d)(4). As a result, however, BF, E , and Investor would become original co-owners in Parent LLC and any subsequent transfer of Parent LLC interests by any of these original co-owners will be counted and cumulated. If more than 50 percent original co-owner interests are transferred, the real property previously excluded from reassessment will undergo a change in ownership.<sup>11</sup>

Change of Profit Allocation between BF and E

Although E 's profit allocations may change, since none of the members of Taxpayer will ever have more than 50 percent in profit allocation, any potential change in profit allocation between BF and E will not result in a change in control of Taxpayer or cumulative transfer of original co-owner interest of more than 50 percent. Therefore, there would be no change in ownership of any real property owned by Taxpayer pursuant to section 64, subdivision (c)(1) or section 64, subdivision (d).

Sincerely,

/s/ Mengjun He

Mengjun He  
Tax Counsel III (Specialist)

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cc: Honorable  
County Assessor/Recorder

Mr. Dean Kinnee MIC:64  
Mr. Benjamin Tang MIC:64  
Mr. Todd Gilman MIC:70

<sup>11</sup> See Rev. & Tax. Code, § 64, subd. (d).