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Executive Director

August 27, 1999

Re: Rule 462.180 Change in Ownership Legal Entities – Request for Legal Opinion

Dear Mr. \_\_\_\_\_ :

This is in reply to your letter of July 9, 1999 in which you request a legal opinion on the application of the provisions of Rule 462.180 pertaining to statutory conversions. Your clients contemplate statutory conversions of general partnerships to limited partnerships and you point to subdivision (d)(4) of Rule 462.180 as providing that a statutory conversion is not a transfer for change in ownership purposes. You request confirmation of your interpretation of that provision and that, as a result of the conversions, the partners will not become original coowners. For the reasons set forth below, statutory conversions are not transfers for purposes of change in ownership. Thus, holders of ownership interests in the converted legal entities will not become “original coowners” after the conversions.

**Factual Background**

Your clients have nine general partnerships (GP) that own real property acquired prior to March 1, 1975. Five of the GPs are owned 25% by Trust A, 25% by Trust C, and 50% by XYZ Family Trust, Survivor’s Trust. Four of the GPs are owned 20% by Trust A, 20% by Trust C, 40% by XYZ Family Trust, Survivor’s Trust and 20% by D. The GPs propose that each general partner will contribute partnership interests to a limited liability company (LLC) which will then own a 1% interest in each partnership. The LLC will be owned 22.78% by Trust A, 22.78% by Trust C, 44.55% by XYZ Family Trust, Survivor’s Trust and 8.89% by D. Each GP will then undergo a statutory conversion to a limited partnership (LP) with the partners all retaining the same proportional interests in each limited partnership. The LLC will become the general partner in each LP.

Upon the death of the beneficiary of Trust A and Trust C, his limited partnership interests will be distributed to D and D’s sibling and upon the death of the beneficiary of the Survivor’s Trust, the beneficiary’s limited partnership interests will be distributed to his (or her) two children.

## **Law and Analysis**

In general, a transfer of ownership interests in a legal entity that owns real property is not a change in ownership of the real property owned by that legal entity pursuant to Revenue and Taxation Code section 64, subdivision (a). However, pursuant to section 64, subdivision (c) a transfer or transfers in which a single individual or entity directly or indirectly obtains more than 50% of the ownership interests is a change in ownership of all real property owned by the entity.

Property Tax Rule 462.180 subdivision (d)(4) interprets Revenue and Taxation Code section 62, subdivision (a)(2) by applying the exclusion from change in ownership to proportional interest transfers of ownership interests in legal entities. Subdivision (d)(4) provides that transfers of ownership interests in legal entities between legal entities or by an individual to a legal entity (or vice versa) which result solely in a change in the method of holding title and in which proportional ownership interests of the transferors and transferees, in each and every piece of property represented by the interests transferred, remain the same after the transfer, do not constitute changes in ownership.

Pursuant to section 64, subdivision (d), if a transfer is excluded from change in ownership pursuant to section 62, subdivision (a)(2) (or Rule 462.180, subdivision (d)(4)), then the persons holding ownership interests in that legal entity immediately after the transfer become "original coowners." Thereafter, the real property subject to the section 62, subdivision (a)(2) exclusion will undergo a change in ownership when cumulatively more than than 50 percent of the total interests in the entity are transferred by any of the original coowners in one or more transactions.

Notwithstanding the section 62, subdivision (a)(2) proportional interest transfer exclusion, subdivision (d)(4) of Rule 462.180 specifies that statutory conversions and statutory mergers are exceptions to the exclusion by providing that the exclusion provisions "shall not apply to a statutory conversion or statutory merger of a partnership into a limited liability company or other partnership (or a limited liability company into a partnership) when the law of the jurisdiction of the converted or surviving entity provides that such entity remains the same entity or succeeds to the assets of the converting or disappearing entity without other act or transfer and the partners or members of the converting or disappearing entity maintain the same ownership interest in profits and capital of the converted or surviving entity that they held in the converting or disappearing entity."

In the GP's proposed first step, the transfer of partnership interests to the LLC in which the LLC becomes a 1% general partner in each general partnership would not result in a change in ownership because, pursuant to section 64, subdivision (a), no single entity or individual has obtained directly or indirectly more than 50% of the total partnership interests.

The proposed second step – the statutory conversions – although it results in a proportional interest transfer and would ordinarily be excluded from change in ownership pursuant to section 62, subdivision (a)(2) and subdivision (d)(4) of Rule 462.10 is expressly made an exception to that exclusion by the latter. Statutory conversions are not considered transfers and, therefore, do not result in changes in ownership. Furthermore, because a statutory conversion is not considered a transfer, and because the proportional interest transfer exclusion has no application, the partners do not become "original coowners" after the conversion.

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Although the partners do not become “original coowners”, the contemplated distributions of the ownership interests upon the death of the beneficiary of Trust A and Trust C to D and D’s sibling would result in a change in ownership of all the property owned by an LP, if D acquires more than 50% of the partnership interests in that LP. After the conversion, Trust A and Trust C would each hold a 19.80% interest and D would hold a 19.80% partnership interest in LP 6, LP 7, LP 8 and LP 9. Upon the death of the beneficiary of Trust A and Trust C, a total of 39.6% of the partnership interests in each LP will have been transferred to D and D’s sibling. If D receives more than 30.2% of that 39.6% interest in any LP, then D will have acquired a total of more than 50% of the interests in that LP, and a change in ownership of that LP’s real property will have occurred pursuant to section 64, subdivision (c).

The distributions upon the death of the beneficiary of the Survivor’s Trust would not result in a change in ownership because either of the beneficiary’s two children could receive only a total of 49.50% of the partnership interests in LP 1, LP2, LP3, LP4, and LP5 and only a total of 39.60% in LP 6, LP 7, LP 8, and LP 9. Thus, no single child could possibly receive a total of more than 50% of the partnership interests in any LP.

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/ Louis Ambrose*

Louis Ambrose  
Tax Counsel

LA:lg

property/precedent/coowners/99/16lou

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