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March 1, 2006

Mr. William C. Hunter
Deputy County Counsel
Merced County
2222 M Street
Merced, CA 95340

Re: *Reassessment of Real Property upon a Transfer from a Partnership to Individual Partners*

Dear Mr. Hunter:

This letter is in response to your August 1, 2005 correspondence addressed to Chief Counsel Kristine Cazadd. In that letter you made an inquiry regarding the reassessment of certain parcels of real property following the transfer of those parcels from a partnership to its partners as tenants in common and subsequent transfers among those individual partners. You questioned whether the exclusion from change in ownership available under subdivision (a)(2) of Revenue and Taxation Code section 62 was inapplicable to those transfers.¹

For the reasons hereinafter set forth, it is our opinion that transfers of proportional interests in real property from a partnership to its former partners as tenants in common would be considered proportional under subdivision (a)(2) of section 62, notwithstanding the enactment of Corporations Code sections 16501, 16502, 16201, and 16203. However, despite the potential exclusion, the step transaction doctrine may require that any future transfers of property interests among these former partners result in a 100 percent change in ownership.

Background and Facts

As described in your letter, the following facts are relevant to this analysis:

1. A partnership conveyed multiple parcels of land to one of the two former partners as individuals, so that one of the former partners took sole title to some parcels while the other partner took sole title to the remaining parcels.

¹All statutory references are to the Revenue and Taxation Code, unless otherwise noted.

2. In the opinion of your county assessor, those conveyances resulted in a change in ownership of all of the parcels of land formerly held by the partnership; the assessor then established new base year values for all of the parcels.
3. Upon discovering the reassessments, the former partners rescinded those transfers by reconveying the parcels of land back to the partnership.
4. Acknowledging the rescission, the county assessor returned those parcels of land to their original base year values.
5. You report that “it has been asserted that if the partners had conveyed the parcels first to themselves as tenants in common and then, in a separate conveyance to each partner, individually, they could have avoided all reassessment.”
6. That conclusion was based on the exclusions found in subdivision (a)(2) of section 62 and Property Tax Rule 462.180, subdivisions (b) and (e).²

Law and Analysis

1. Do transfers of proportional real property interests from a partnership to its former partners as tenants in common qualify for the change in ownership exclusion available under Revenue and Taxation Code section 62, subdivision (a)(2)?

Yes.

When any legal entity, such as a partnership, transfers real property to an individual or individuals, you correctly observe that the transfer is considered to be a change in ownership and results in reappraisal of the property transferred (subdivision (j) of section 61). Unless the transaction qualifies for an exclusion, this result is automatic whether the property is transferred by purchase, gift, devise, or any other means of conveying present beneficial ownership. (Property Tax Rule 462.001.)

Subdivision (a)(2) of section 62 provides for the only exclusion from change in ownership for transfers between a legal entity and any individual. To qualify for the exclusion, such transfers must result solely in a change in the method of holding title to the real property, and the proportional interests of the transferors and transferees must remain exactly the same before and after the transfer in each and every piece of real property transferred. Under the express terms of this statute, the exclusion applies to transfers from a co-tenancy to a partnership, a partnership to a corporation, and from a trust to a co-tenancy. In our prior opinions, we have applied this exclusion to transfers between a partnership and its partners (see Property Tax Annotation No. 220.0493, enclosed).

² All Property Tax Rule, or Rule references are to Title 18 of the California Code of Regulations.

In order for a transfer of real property from a partnership to the individual partners to be proportional, each partner's percentage interest in the real property after the transfer must be identical to the percentage interest they each held in the partnership capital and profits before the transfer. (Property Tax Rule 462.180, subd. (b)(2).) The California Courts of Appeal have held that when real property is transferred to individual owners from a legal entity, that transfer is excluded from the definition of a change in ownership pursuant to section 62(a)(2) *only* if the proportional interests of each owner in each piece of real property remains identical after the transfer. [Emphasis added.] (*Kern v. Imperial County* (1990) 226 Cal.App.3d 391 and *Munkdale Brothers v. Giannini* (1995) 35 Cal.App.4th 1104.) Thus, if each partner owns a 50 percent interest in the partnership capital and profits before the transfer, the same partners must each own a 50 percent interest in each and every parcel of real property after the transfer (Letter To Assessors No. 91/43).

To determine whether a transfer of real property from a partnership to its individual partners satisfies the proportionality requirements of subdivision (a)(2) of section 62, the county assessor will review the percentage interests each of the partners held in capital and profits before the transfer and the interests in every parcel of real property formerly owned by the partnership after the transfer. Unless the interests held before and after the transfer are completely identical, a change in ownership of all real property formerly held by the partnership has occurred.

From the facts presented above, each partner held an interest in the partnership's capital and profits before any transfer. Upon executing the documents necessary to convey the parcels of real property, the partnership granted ownership of each individual parcel to one of the former partners. That step resulted in one partner obtaining 100 percent ownership of some the parcels at the same time the other partner obtained 100 percent ownership of the remaining parcels.

Given the fact that one of the former partners obtained sole ownership of some parcels while the other former partner acquired sole ownership of the remaining parcels, the proportionality requirement of this exclusion was not met. A concurrent transfer of *any* interest in the partnership's real property to any individual who did not own an *identical* interest in the partnership's capital and profits is enough to destroy proportionality and result in a 100 percent reappraisal of the property formerly held by the partnership. Thus, the assessor correctly reassessed these parcels of real property for a change in ownership.

In an attempt to rescind the changes in ownership described above, the parcels were reconveyed to the partnership. We have opined on multiple occasions that no authority precludes an assessor's office from recognizing a valid rescission. (See Property Tax Annotation No. 220.0595, enclosed.) A rescission of a transfer of real property returns the parties to their original positions prior to the transfer of the subject property taking effect. However, in the context of property taxes, the rescission can have only prospective application; no refund of taxes is available to the parties for the period of time under which a conveyance is treated as a change in ownership, as the conveyance was effective for that period of time. This is so since property taxes are determined by the facts as they exist on the lien date. (*Doctors General Hospital v. Santa Clara County* (1957) 150 Cal. App. 2d 53; *Estate of Bakesto* (1923) 63 Cal. App. 265; *Parr-Richmond Industrial Corp. v. Boyd* (1954) 43 Cal. 2d 157.)

After rescinding the original transfers, the partnership conveyed the parcels of real property to the former partners as tenants in common, with each partner obtaining an interest in each parcel equal to his or her share of partnership capital and profits. Since these later transfers maintained each partner's proportional ownership interests in each and every piece of real property, it is our opinion that those transfers qualify for the section 62, subdivision (a)(2) exclusion.

2. Do the subsequent transfers from the former partners as tenants in common to one of the two individual partners qualify for the section 62(a)(2) exclusion?

No. The step transaction doctrine requires that the assessor process a 100 percent change in ownership for each parcel following any transfer from one former partner to the other.

While the transfers of proportional property interests between a partnership and its partners may qualify for the section 62(a)(2) exclusion, transfers of property interests between the former partners do not. Upon executing the deeds conveying sole ownership of the affected parcels to one partner or the other, such transactions would result in a change in ownership in the percentage of each parcel transferred to the other partner. However, as applied to the facts in this situation, the step transaction doctrine requires that such transfers result in a 100 percent change in ownership reappraisal of those parcels.

To apply the section 62, subdivision (a)(2) exclusion where two individual partners held equal 50 percent ownership interests in a partnership owning real property, they would need to be equal 50 percent owners of the real property distributed to themselves from the partnership. If, however, one or more other steps are undertaken to complete the transaction, then the application of the "step transaction doctrine" becomes a relevant consideration, and a change in ownership may have occurred.

The "step transaction doctrine" has been applied to property transfers when unnecessary steps are taken merely to circumvent the intent of the change in ownership statutes. In such cases, 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.)

In *Shuwa*, the court presented three possible tests for the application of the step transaction doctrine. The "end result test" looks at the various steps as component parts of a single transaction. The "interdependence test" focuses on whether one step would have been taken without any of the other steps apart from the parties' intent to qualify for an exclusion. The final test, known as the "binding commitment test," examines whether the structure of the transactions is such that taking the first step, in effect, constitutes a binding commitment to follow through with the entire transaction, e.g., the parties agree to specified transfers in a certain chronological order, beginning with the first, in order to complete the entire transaction.

Determinations regarding the application of the step transaction doctrine are based upon a thorough understanding of all the surrounding facts; any conclusions ultimately rest with the assessor evaluating the situation. For purposes of this analysis, the facts appear to show that the end result contemplated by the former partners was that one partner would obtain sole ownership

of some of the partnership's real property while the other partner would obtain sole ownership to the remaining parcels. We base this conclusion on the fact that the partners' original transactions were ultimately rescinded after the assessor correctly reassessed the parcels in question.

It is clear that if, at the outset, the partnership had deeded some of the parcels to one partner and the remaining parcels to the other partner, a 100 percent change in ownership of all of the parcels of real property would have occurred (see our answer to Question No. 1, above). However, by distributing to each partner their respective interests in real property as tenants in common, the parties took an extra step in an attempt to utilize the section 62, subdivision (a)(2) exclusion. Such a step would appear to exclude from reappraisal the real property interests retained by each partner, while subjecting to reappraisal the real property interests transferred from one partner to the other.

This fact pattern describes exactly the type of situation the step transaction doctrine was intended to address by authorizing the county assessor to "look through" the transaction. We have advised in Letters to Assessors Nos. 92/69 and 95/33 that decisions leading to reassessment should be made by assessor if, based upon all of the facts of any given transaction, those facts demonstrate that, in substance, a change in ownership has occurred.

These partners apparently had the same related purpose and intent since the beginning of these transactions. That is, one partner would obtain sole ownership of some parcels, while the other partner would obtain sole ownership of the remaining parcels. Thus, the tests in *Shuwa* are satisfied when the step transaction doctrine is applied. Under both the "end result" test and the "binding commitment" test, the partners have been pursuing a related intent throughout all of these transactions. Lastly, all of these steps were "interdependent" on one another to achieve the end result sought by the partners—specifically to qualify for the section 62, subdivision (a)(2) exclusion, and thereby limit the change in ownership to only those portions of the parcels transferred from one former partner to the other. In our opinion, these transfers of interests in real property among the former partners result in a 100 percent change in ownership of all the property so transferred.

3. Did the enactment of Corporations Code sections 16501, 16502, 16201, and 16203 effectively abolish the change in ownership exclusion available to partnerships under Revenue and Taxation Code section 62, subdivision (a)(2)?

No. The result described in our answer to Question No. 1 above occurs notwithstanding the enactment of Corporations Code sections 16501, 16502, 16201, and 16203.

On page two of your letter you question whether the enactment of Corporation Code section 16501 prevents a partnership from making proportional interest transfers of its property:³

Of course, because of Corporations Code section 16501, partners hold no title in the partnership property nor can there be any proportionate interests to even consider since, again, they hold no title prior to any conveyance. Thus, any transfer or conveyance of the partnership property seemingly must always be a

³ Section 16501 of the Corporations Code provides that "A partner is not a coowner of partnership property and has no interest in partnership property that can be transferred, either voluntarily or involuntarily."

100% change in ownership (e.g., partnership as owner to the transferee as owner, whether partner or otherwise, as provided in Revenue and Taxation Code section 61(j), unless otherwise excepted. [Emphasis in original.]

Essentially, you believe that the partners' lack of individual ownership interests in the partnership property prevents that partnership from conveying proportional interests in that property to the individual partners. We respectfully disagree.

It has been a long-held opinion of the Board that the section 62, subdivision (a)(2) exclusion applies to proportional interest transfers between any legal entity and an individual, whether that entity is a partnership, corporation, or limited liability company (LLC). We have specifically opined that the exclusion applies to transfers between a corporation and its shareholders (Property Tax Annotation No. 220.0085, enclosed), and an LLC and its members (Property Tax Annotation No. 220.0375, enclosed), even though the shareholders of a corporation or members of a LLC hold no title to the property owned by the corporation or LLC.

In addition, proportional transfers of real property of between legal entities and individuals are expressly excluded by Property Tax Rule 462.180. Subdivision (b) of Rule 462.180 provides, in pertinent part:

(b) EXCEPTIONS. The following transfers do not constitute changes in ownership of the real property:

* * *

(2) PROPORTIONAL TRANSFERS OF REAL PROPERTY. Transfers of real property . . . 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 the proportional ownership interests in each and every piece of real property transferred remain the same after the transfer. . . .

In the case of a corporation, Example 5 in subdivision (b)(2) of Property Tax Rule 462.180 illustrates the application of this exclusion:

Example 5: A transfer of real property from Corporation X to its sole shareholder A. No change in ownership, even if A is an "original co-owner," because interests in real property, and not ownership interests in a legal entity, are being transferred.

From that example, it is clear that the section 62, subdivision (a)(2) exclusion applies when a corporation transfers real property to its shareholder, even though that shareholder holds no title to the property owned by the corporation itself. Thus, it is our opinion that this exclusion should also apply to partnership property, even though the partners as individuals do not hold title to the partnership property. That opinion remains unchanged after the enactment of Corporations Code sections 16501, 16502, 16201, and 16203.

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.

Sincerely,

A handwritten signature in black ink that reads "Michael Lebeau". The signature is written in a cursive, flowing style with a long horizontal stroke at the end.

Michael Lebeau
Senior Tax Counsel

ML:jlh

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Enclosures

cc: Honorable David A. Cardella
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Mr. David Gau, MIC:63

Mr. Dean Kinnee, MIC:64

Ms. Mickie Stuckey, MIC:62

Mr. Todd Gilman, MIC:70