

M e m o r a n d u m

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Date: January 22, 2015

From: Mengjun He (MIC: 82)
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Subject: *Request for Legal Opinion - BOE-100-B, Statement of Change in Control and Ownership of Legal Entities for Partners LP Assignment No. 14-338*

This is in response to your September 24, 2014 request for our opinion on whether a May 1, 2007 transaction involving Partners, LP (Taxpayer) is excluded from change in ownership. As explained below, the transaction resulted in a change in control of Taxpayer under Revenue and Taxation Code section¹ 64, subdivision (c)(1) and does not qualify for any exclusion from change in ownership.

Specifically, Taxpayer contends that no change in ownership resulted from the May 1, 2007 transaction because one entity, N Properties, LLC (N), held indirect control of Taxpayer before and after the transaction. We disagree. As explained below, even if N held indirect control of Taxpayer before and after the transaction, a new entity obtained direct control of Taxpayer as a result of the transaction.

Factual Background

Taxpayer owns 100 percent of Hotel, the real property. Before the May 1, 2007 transaction, Taxpayer was owned 87.20 percent by W Associates (W) and 12.80 percent by Partnership. W in turn had three partners, one of which was N . N had a 57.5 percent direct ownership interest in W .

On May 1, 2007, Taxpayer's two partners withdrew from the partnership and contributed all of their interests in Taxpayer to two new entities, H Venture, LLC (H Venture), and P GP (P).

After the May 1, 2007 transaction, Taxpayer was owned 99.90 percent by H Venture and 1.0 percent by P , which in turn was 100 percent owned by H Venture. H Venture had three members, one of which was Group which owned a 66.67 percent membership interest. One of Group's members was N , which owned a 59.50 percent interest in Group.

¹ Unless otherwise specified, all references to "section" or "sections" refer to sections of the Revenue and Taxation Code.

Taxpayer first filed form BOE-100-B, *Statement of Change in Control and Ownership of Legal Entities*, on September 19, 2009, reporting a change in control of Taxpayer, indicating that H Venture obtained a 99.00 percent direct interest in Taxpayer as a result of the May 1, 2007 transaction. But on March 12, 2012, it amended the report to state that there was no change in control, claiming that the indirect control of Taxpayer remained with N , which had a controlling indirect interest in Taxpayer through its partnership interest in W before the transfer and retained a controlling indirect interest in Taxpayer through its indirect ownership interest in H Venture after the May 1, 2007 transfer.²

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 section 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 general rule is set forth in section 64, subdivision (c)(1), which provides that:

When a corporation, partnership, limited liability company, other legal entity, or any other person 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 ownership interest in any partnership, limited liability company, or other legal entity through the purchase or transfer of corporate stock, partnership, or limited liability company interest, or ownership interests in other legal entities . . . the purchase or transfer of that stock or other interest shall be a change of ownership of the real property owned by the corporation, partnership, limited liability company, or other legal entity in which the controlling interest is obtained. (Emphasis added.)

"Control" is further defined and applied to partnerships and limited liability companies specifically in Property Tax Rule³ 462.180, subdivision (d)(1)(B), which states that a change in ownership occurs when a partnership, limited liability company or other legal entity:

obtains through multi-tiering, reorganization, or any transfer *direct or indirect ownership* of more than 50 percent of the total interest in partnership or LLC capital and more than 50 percent of the total interest in partnership or LLC profits (Emphasis added.)

Rule 462.180, subdivision (d)(1) further states that:

² As whether any entity retained indirect control in Taxpayer is immaterial based on our legal analysis below, it is unnecessary for us to compute the exact indirect ownership percentage N had in Taxpayer before or after the May 1, 2007 transfer.

³ Cal. Code Regs., tit. 18, §462.180. All further "Rule" references are to sections of Title 18 of the California Code of Regulations.

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. (Emphasis added.)

Thus, both the statute and the regulation state that a change in ownership occurs when a new entity obtains control, whether *directly or indirectly*, of an entity that owns real property. This is also highlighted by *Kraft, Inc. v. County of Orange* (1990) 219 Cal.App.3d 1104 (*Kraft*). In that case, Kraft, Inc. (Kraft), and Dart Industries, Inc. (Dart), formed a new corporation, Dart & Kraft, Inc. (DKI). DKI in turn set up two wholly owned subsidiaries which were then merged into Kraft and Dart. As part of the transaction, the Kraft and Dart shareholders converted their respective Kraft and Dart shares into shares of DKI stock. As a result, DKI obtained a 100 percent interest in both Kraft and Dart, and the former Kraft shareholders became owners of 51.50 percent of the DKI stock. Kraft argued that it did not undergo a change in control under section 64, subdivision (c)(1) because the Kraft shareholders became the majority shareholders of DKI and therefore indirectly continued to control Kraft after the transfer. However, noting that the plain language of section 64, subdivision (c)(1) provides that a change in control can occur directly or indirectly, the court responded to Kraft's contentions as follows:

Kraft misses the point. The same shareholders did maintain control, but a *new* corporation obtained *direct* control. Kraft overlooks the statute's language which provides for reassessment when a new entity obtains control whether *directly or indirectly*.⁴

Thus, when a new person or legal entity obtains direct control of an entity, a change in control under section 64, subdivision (c)(1) occurs, even if a formerly direct owner maintains indirect control through its ownership of the new entity that obtained direct control.⁵

That is exactly the case here. Before the May 1, 2007 transaction, W had direct control of Taxpayer, but after the May 1, 2007 transaction, H Venture, a different entity, gained *direct* control of Taxpayer. Taxpayer's original BOE-100-B filing reports this fact.

Because H Venture gained direct control of Taxpayer after the May 1, 2007 transaction, a change in control of Taxpayer occurred. (Rev. & Tax. Code, § 64, subd. (c)(1), Rule 462.180, subd. (d)(1).) For that reason, the May 1, 2007 transaction resulted in a change in control of Taxpayer, and should lead to 100 percent reassessment of all real property owned by Taxpayer. Even if N held indirect control of Taxpayer before and after the May 1, 2007 transaction, it does not change the fact that H Venture gained direct control of Taxpayer.⁶

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⁴ *Id.* at 1108. (Emphasis in original.)

⁵ See also *Title Ins. & Trust Co. v. County of Riverside* (1989) 48 Cal.3d 84, 92 ("The fundamental requirement for a change in ownership under [section 64, subdivision (c)] is the obtaining of control of the corporation that owns the property subject to reassessment, whether that control is obtained directly or indirectly.")

⁶ We also note that the section 62, subdivision (a)(2) exclusion from change in ownership does not apply since it appears that the ownership interests in Taxpayer did not remain the same before and after the transaction.