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December 14, 2010

Honorable Tom J. Bordonaro, Jr.
San Luis Obispo County Assessor
ATTN: Ms.
1055 Monterey Street, Suite D360
San Luis Obispo, CA 93408-2070

Re: Taxability of Property
Assessor's Parcel Numbers:
Assessment Appeal Number:
Assignment Number: 10-131

Dear Ms. :

This is in response to your August 3, 2010 letter inquiring whether certain property owned by (C) is exempt from property taxation. C asserts that all assessments on the parcels listed above are exempt from property taxation after 100 percent of its membership shares were acquired by the California State Teachers' Retirement System (CalSTRS). C argues that since CalSTRS is an instrumentality of the State of California exempt from property taxation, any property owned by C is also exempt. In the alternative, C argues that the property should be exempt under the college or public schools exemption, or Revenue and Taxation Code section 214, subdivision (g)(1). As explained in further detail below, it is our opinion that none of the above-referenced parcels is exempt.[1]

Facts

Your letter includes a summary of the relevant facts as explained by K , agent for C, which states in relevant part:

> The subject real property was originally purchased by LLC (M). M was 100% owned by Partners LP (LP), a limited partnership with two partners, Properties (CO) and CalSTRS, with CalSTRS holding a controlling 2/3 interest in the partnership.
>
> In December 2006, CalSTRS exercised its rights under a Buy/Sell agreement to "buy out" CO's interest in LP. After this transaction was complete, CalSTRS owned 100% of LP, 100% of M and therefore 100% of the subject property. LP was then converted to Partner LLC (LLC) as a partnership cannot exist with only one partner.

[1] This opinion is being requested in connection with a hearing before the San Luis Obispo County Assessment Appeals Board. Both parties are aware that we will be issuing this opinion, have examined and/or provided the facts set forth herein, and were given an opportunity to provide additional information in connection with this letter.

M then had a name change to C.

The fee properties in question constitute an apartment complex used predominantly by students attending California Polytechnic State University (Cal Poly). C has also been assessed for a possessory interest that is an encroachment on a parking lot owned by Cal Poly.

Your letter included several enclosures, including the "Property Management and Leasing Agreement- Apartments" by and between , Inc. and C, dated as of December 26, 2006 (Property Management Agreement). You did not provide a copy of the C Operating Agreement, however there is no indication that the LLC has a stated charitable purpose. Further, it appears that C is not in any way affiliated with Cal Poly. For example, it is not statutorily sanctioned and regulated as an Auxiliary Organization with respect to Cal Poly and the State of California under Education Code section 89900 et seq., nor are there any indications that an express agreement exists whereby C is obligated to provide off-campus housing exclusively to Cal Poly students, faculty, and staff, or perform any other functions specified in California Code of Regulations, Title 5, section 42500, for the benefit of Cal Poly.

Law & Analysis

Article XIII, section 1 of the California Constitution provides that all property is taxable "[u]nless otherwise provided by the Constitution or laws of the United States." However, as you know, section 3, subdivision (a) of article XIII of the California Constitution exempts all property owned by the state from property tax.[2] When property is acquired either by the state or a local agency, all or a part of the taxes may be subject to cancellation, depending on whether the acquisition takes place before or during the applicable fiscal year.[3]

There is no dispute that property owned directly by CalSTRS is property owned by the state qualified for exemption under article XIII, section 3, subdivision (a). (See Ed. Code, § 22000 et seq.) However, it is equally clear that ownership of a limited liability company that owns real property is not equivalent to direct ownership of that real property.

Corporations Code section 17300 states, "A membership interest and an economic interest in a limited liability company constitute personal property of the member or assignee. A member or assignee has no interest in specific limited liability company property." A limited liability company has a legal existence separate from its members, and provides its members with limited liability to the same extent enjoyed by corporate shareholders. Like corporate shareholders, members of a limited liability company hold no direct ownership interest in the company's assets.[4] Moreover, a member in a limited liability company does not hold any interest in the real property owned by the limited liability company.[5] Once members contribute assets to an LLC, those assets become assets of the LLC and the members lose any direct ownership interest they had in the assets.[6]

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[2] See also Rev. & Tax. Code, § 202, subd. (a)(4).
[3] Rev. & Tax. Code, § 4986.
[4] See *Denevi v. LGCC, LLC* (2004) 121 Cal.App.4th 1211.
[5] *Fashion Valley Mall, LLC v. County of San Diego* (2009) 176 Cal.App.4th 871.
[6] *Abrahim & Sons Enterprises v. Equilon Enterprises* (9th Cir. 2002) 292 F.3d 958.

For these reasons, the Legal Department of the Board of Equalization has opined in Property Tax Annotation (Annotation) 490.0045 (September 17, 1987) that a convention center improvement owned by a corporation that is wholly owned by a city is not exempt from property tax despite the fact that the city controlled the corporation as its sole shareholder. The "separate entity" theory underlies the basis of the annotated legal opinion, which states, "The corporate entity formed by City must be treated as an entity separate and apart from City. Thus, property owned by the corporation cannot be deemed to be owned by City without legislation so providing." The same result was reached in Annotation 490.0065 (December 11, 1996), which states, "The Board of Equalization has long held the view that property of a corporation owned by a local government is not exempt from property tax as property owned by a local government."

Mr. K , however, maintains that the parcels should be exempt as state-owned property under section 3, subdivision (a) of article XIII of the state Constitution, and, citing Government Code section 7510, subdivision (b)(1), that Annotations 490.0045 and 490.0065 do not apply to this situation since ownership of the parcels in question is through an LLC, not a corporation, and since Annotations 490.0045 and 490.0065 address local governments instead of state public retirement systems. We disagree. First, the separate entity theory is equally applicable to LLCs as it is to corporations. Corporations Code section 17300 specifically states that members of a limited liability company hold no direct ownership interest in an LLC's assets, and as such, ownership of such interests is not simply a method of holding title tantamount to direct ownership. The Legal Department has also opined that for property tax purposes, an LLC is a separate and distinct entity from its sole member.[7] Thus, although limited liability companies may be treated as a disregarded entity and "looked through" for income tax purposes, such is not the case for California property tax purposes.[8]

Second, we do not agree that Government Code section 7510, subdivision (b)(1), mandates that state public retirement systems are treated differently than local governments for purposes of exempting property as state-owned. It states in relevant part:

> Whenever a state public retirement system, which has invested assets in real property and improvements thereon for business or residential purposes for the production of income, leases the property, the lease shall provide, pursuant to Section 107.6 of the Revenue and Taxation Code, that the lessee's possessory interest may be subject to property taxation and that the party in whom the possessory interest is vested may be subject to the payment of property taxes levied on that interest.

Thus, contrary to Mr. K 's assertion, this statute is not related to whether a state public retirement system is treated differently than a local government for purposes of exemption, but is rather a statute requiring that a lease of CalSTRS property contain language stating that a lessee may be subject to a taxable possessory interest. Notably, the statute applies to investments in real property and improvements thereon, and does not apply to investments in legal entities, such as LLCs, that own real property. This is supported further by Government Code section 7510, subdivision (b)(3). That section provides specifically that investment by a state public retirement system in a legal entity that invests assets in real property and improvements is not an investment

[7] Annotation 220.0375.015 (February 15, 2000).
[8] Annotation 220.0375.015, *supra*, (February 15, 2000).

by the state public retirement system of assets in the real property and improvements themselves. It states:

> An investment by a state public retirement system in a legal entity that invests assets in real property and improvements thereon *shall not constitute an investment by the state public retirement system of assets in real property and improvements thereon*. For purposes of this paragraph, "legal entity" includes, but is not limited to, partnership, joint venture, corporation, trust, or association. When a state public retirement system invests in a legal entity, the state public retirement system shall be deemed to be a person for the purpose of determining a change in ownership under section 64 of the Revenue and Taxation Code. (Emphasis added.)

Mr. K argues that the legislative intent of Government Code section 7510, subdivision (b)(3), is not applicable to this situation as it was meant to address partial ownership of property or investments, not wholly owned legal entities. However, this assertion is not supported by the plain language of the statute. If the legislature did not intend for this subdivision to apply to wholly owned legal entities, the legislature could have so provided.

We also believe that the parcels should not be exempt under the college or public schools exemptions.[9] These exemptions provide that "Property…used exclusively for public schools, community colleges, state colleges, and state universities" is "exempt from property taxation." In order to qualify, the property must be used exclusively for educational purposes.[10] With respect to the college exemption, the Court of Appeal has construed the requirement that property be "used exclusively for educational purposes" to include any facilities which are "reasonably necessary to the fulfillment of a generally recognized function of a complete modern college."[11] The Court of Appeal has also held that a 3.56 percent nonpublic school use of a computer system leased by a public school system disqualified it from the public schools exemption.[12]

It is our understanding that a large number of tenants in the apartment complex are students at Cal Poly or are otherwise associated with Cal Poly. We have no doubt that property "used exclusively for educational purposes" includes *college or university-provided* faculty and student housing because such housing furthers the primary educational purpose of a university or college and is reasonably necessary for the fulfillment of a generally recognized function of a complete and modern college or university.[13] In this case, however, there is no indication that Cal Poly is involved in providing this housing in any way. We understand that there is no written agreement between C and Cal Poly for the provision of off-campus housing to Cal Poly students, and that there are no restrictions or contracts that require the units to be leased exclusively to Cal Poly students. Moreover, the Property Management Agreement does not restrict leasing of the units to Cal Poly students and faculty. Section 3.01 of the Property Management Agreement simply requires the manager to "cause the Property to be rented to suitable, creditworthy tenants, as determined by Manager." Section 4.10 permits the manager to "provide monetary discounts for accommodations to its employees specifically working at the

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[9] Cal. Const., art. XIII, § 3, subd. (d), implemented by Rev. & Tax. Code § 202, subd. (a)(3).
[10] *Mann v. County of Alameda* (1978) 85 Cal.App.3d 505.
[11] *Church Divinity School v. County of Alameda* (1957) 152 Cal.App.2d 496.
[12] *Honeywell Information Systems, Inc. v. County of Sonoma* (1974) 44 Cal.App.3d 23.
[13] See *Mann v. County of Alameda* (1978) 85 Cal.App.3d 505.

Property who desire to live on-site," which further indicates that tenants are not required to be students or faculty of Cal Poly. In fact, the one-page rental application that may be downloaded from the website does not inquire whether prospective tenants are affiliated with Cal Poly in any way. In our opinion, the mere fact that the apartments are located near campus, and thus most of the residents are Cal Poly affiliated, does not make the apartments eligible for the college or public schools exemption.

Finally, the property does not qualify for exemption under Revenue and Taxation Code section 214, subdivision (g)(1). That subdivision permits certain low-income housing properties to qualify for the welfare exemption when such property is owned and operated by certain nonprofit organizations, including limited liability companies with a qualifying managing general partner. In this case, there is no indication that the parcels are used for low-income housing purposes, nor is there any indication that C is a nonprofit organization qualified to receive the welfare exemption on any property it owns.

In the absence of any legal authority which would dictate a different result, based on the facts presented in your letter, we conclude that the parcels are not eligible for exemption from property taxation as state-owned property, nor are such parcels eligible for the public schools exemption, the college exemption, or the welfare exemption.

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

Sincerely,

/S/ Mary Anne B. Tooke

Mary Anne B. Tooke
Tax Counsel

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cc: Mr. K

Mr. David Gau MIC:63
Mr. Dean Kinnee MIC:64
Mr. Todd Gilman MIC:70