Summary: Creates a new "change in ownership" event for real property owned by legal entities when 90 percent or more of direct or indirect ownership interests in that legal entity transfer or sell in a planned single transaction.

Specifically, this bill:

- Requires reassessment of a legal entity's real property holdings when 90 percent or more of its ownership interests are sold or transferred in a "single transaction," except when the sale or transfer qualifies for an exclusion from change in ownership. Section 64(c)(1)(B)(i)

- Defines "single transaction" to mean a plan consisting of one or more sales or transfers of ownership interests that occur on or after January 1, 2019. Section 64(c)(1)(B)(ii)(IV)
  - Creates a rebuttable presumption that sales or transfers are part of a single transaction when the transferees (buyer) are related persons/entities or fiduciaries per federal law,\(^1\) thus effectively allowing counting of the cumulative ownership interests of all the related parties to reach the 90 percent or more threshold. Section 64(c)(1)(B)(ii)(IV)(ia)
  - Creates a rebuttable presumption that sales or transfers occurring within a 36-month period are part of a single transaction, thus allowing cumulative counting of ownership interest transfers to reach the 90 percent threshold. Section 64(c)(1)(B)(ii)(IV)(ib)

- Provides that "sold or transferred" does not include:
  - Certain transfers that occur upon death (i.e., inheritance). Section 64(c)(1)(B)(ii)(V)(ia)
  - Publicly traded corporate stock or partnership interest sales occurring in regular trading activity on an established securities market. Section 64(c)(1)(B)(ii)(V)(ib)

- Provides that indirect ownership or transfer of ownership interests is to be measured proportionately. Section 64(c)(3)

- Provides that once an ownership interest is counted to determine whether a change in control or ownership of a legal entity has occurred, that interest is not counted again in determining whether any other sale or transfer of ownership interests results in a change in ownership of the real property reassessed as a result of the change in control or ownership. Section 64(f)

- Authorizes the BOE to prescribe new regulations to carry out the purposes of this section. Section 64(g)

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\(^1\) 26 U.S.C. section 267(b).

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- Requires the legal entity to report a change in ownership event pursuant to Section 64 to the Board of Equalization (BOE) within 90 days. Sections 480.1, 480.2, 482
- Increases the penalty from 10 percent to 15 percent for legal entities that do not report any reassessable event to the BOE. Sections 480.1, 480.2, 482
- Requires the BOE to notify assessors when legal entity reassessment events occur. Section 480.9
- Requires the BOE to report the reassessments occurring under the new CIO event and its economic impact by 2021. Section 486

Purpose: To trigger more frequent legal entity changes in ownership when a 90 percent or more ownership interests in a legal entity sell or transfer even though ownership control was not obtained by any person or legal entity.

Fiscal Impact Summary: The annual revenue gain could amount to about $269 million.

Existing Law: For property tax purposes, real property is reassessed from its Proposition 13 protected value (called a "base year value" (BYV)) to its current market value when real property undergoes a change in ownership.²

Change in Ownership. When a "change in ownership" occurs, the law requires the assessor to reassess the property to its current fair market value.³ Different laws apply to a person who buys real estate and a person who obtains ownership interests in a legal entity that owns real estate.

Interests in Real Property. Revenue and Taxation Code (RTC) section 61(j) provides that a change in ownership includes the transfer of any interest in real property between a corporation, partnership, or other legal entity and a shareholder, partner or any other person. As a general rule, the law requires a reassessment equal to the percentage interest transferred.

Interests in Legal Entities. RTC section 64 sets forth the change in ownership provisions for the purchase or transfer of ownership interests in legal entities (e.g., stock in a corporation, interests in a limited liability company, or interests in a partnership) that own real property. As a general rule, under section 64(a), transfers of ownership interests in legal entities do not constitute a change in ownership (and, therefore, no reassessment) of the legal entity's real property. However, there are two exceptions wherein the transfer of ownership interests in a legal entity would trigger a change in ownership:

• Change in Legal Entity Control. Section 64(c)(1) requires reassessment when any person or entity obtains control through direct or indirect ownership or control, of more than 50 percent of corporation voting stock, or obtains more than a 50 percent ownership interest in any other type of legal entity. The reassessment covers all real property owned by the acquired legal entity (and any entity under its control).

• Cumulative Transfers by "Original Co-owners."³⁴ Section 64(d) requires reassessment when voting stock or other ownership interests representing cumulatively more than 50 percent of

² California Constitution, article XIII A, section 2; RTC section 110.1.
³ California Constitution article XIII A, section 2; RTC sections 60 – 69.5.
⁴ Proportional Ownership Interests Exclusion Creates "Original Co-owner" Designation. Under section 62(a)(2), a transfer of real property to a legal entity does not result in a reassessment if the transfer is merely a change in the method of holding title and the proportional ownership interests in the real property are exactly the same before and after the transfer. However,

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the total interests in a legal entity are transferred by any of the "original co-owners" in one or more transactions. The reassessment covers the real property previously excluded from change in ownership under section 62(a)(2).

**Indirect Ownership.** Existing statutes do not specify the method of counting indirect ownership of legal entity ownership interests.

**Counting Interest.** Currently ownership interests of spouses are not counted together as a single unit, regardless of whether the ownership interests are separate property or community property. With respect to immediate families, parents, children, and siblings' interests are also counted separately for each person.

**Self-Reporting Requirement.** Existing law requires legal entities to file a change in ownership statement (LEOP COS) with the BOE within 90 days of a change in control or change in ownership under section 64(c) or (d). In the case of a change in control under section 64(c), the person or legal entity that acquired control of the legal entity is responsible for filing the LEOP COS.

**Requirement to File Upon Request.** Despite the self-reporting requirement to file a LEOP COS, the BOE may send a LEOP COS to an entity to complete and file with the BOE. Annually, the BOE canvasses legal entities with a query on the state income tax return. Additionally, the BOE monitors business publications to identify mergers and acquisitions. Assessors and other interested parties also send referrals reporting possible changes. A legal entity that fails to respond to a BOE request may incur a penalty.

**Penalty.** A penalty applies if the LEOP COS is not filed within 90 days. The penalty amount is 10 percent of the taxes applicable to the new base year value reflecting the change in control or change in ownership of the real property owned by the legal entity. In cases where the legal entity fails to respond to BOE's request to file, the legal entity may incur a penalty. If a legal entity fails to timely file, but no change in control or change in ownership has occurred, the penalty is 10 percent of the current year's taxes.

**Proposed Law:**

**Transfers of Ownership Interests in Legal Entities: Change in Ownership Trigger Event.** This bill provides that when 90 percent or more of the direct or indirect ownership interests in a legal entity transfer in a single transaction, the transfer of the ownership interests is a change of ownership of the real property the legal entity owns, including the real property owned by a legal entity under its control. A change in ownership triggers reassessment. *Section 64(c)(1)(B)*

"Single transaction" means a plan consisting of one or more sales or transfers of ownership interests that occur on or after January 1, 2019. *Section 64(c)(1)(B)(iv)“(IV)*

**Rebuttable Presumption.** There is a rebuttable presumption that a sale or transfer is part of a single transaction if either of the following occur:

after a transfer of real property qualifies for this exclusion from reassessment, the persons holding ownership interests in the legal entity immediately after the transfer are considered "original co-owners" for purposes of tracking subsequent transfers by original co-owners of those interests. When such transfers cumulatively exceed 50 percent, the real property previously excluded from reassessment under section 62(a)(2), is deemed to undergo a change in ownership, and is, therefore, subject to reassessment under section 64(d).

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5 Legal Entity Ownership Program (LEOP) Change of Ownership (COS) is detailed on page 6 of this analysis.

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In General: Property Tax System. In 1978, voters changed California's property tax system with the approval of Proposition 13. Under this system, a property's assessed value is based on its 1975 fair market value until the property changes ownership. Thereafter, annual assessed value increases are limited to 2 percent or the inflation rate, whichever is less. When the property changes ownership, it is reassessed to its current market value, which is generally the sales price, and annual future increases to that value are subject to the same limits.

Change in Ownership. While Proposition 13 provided a "change in ownership" reassessment trigger, it did not define this key phrase. The Assembly Revenue and Taxation Committee appointed a special Task Force to recommend the statutory implementation for Proposition 13 and define change in ownership. The Task Force consisted of 35 members, including legislative and BOE staff, county assessors, public and private sector attorneys, and trade associations.


Property Owned by Legal Entities. One issue the Task Force faced was how to apply Proposition 13's change in ownership provisions to property owned by a legal entity. For instance, would a transfer of ownership interests in a legal entity that owns real property be considered a transfer of the real property interests and, thus, a change in ownership? The Task Force considered two alternatives: the "separate entity theory" and the "ultimate control theory."

- **Separate Entity Theory.** The separate entity theory respects the separate identity of the legal entity. Accordingly, as long as the legal entity owns the property it will not be reassessed, even if all of the ownership interests in the legal entity transfer.

- **Ultimate Control Theory.** The ultimate control theory looks through the legal entity to determine who holds the ownership interests and, thus, who has "ultimate control" of the legal entity. Under this theory, real property owned by the legal entity is reassessed only when a single holder of ownership interests gains control of the legal entity through the acquisition of a majority of the ownership interests.

The Task Force recommended the separate entity theory be adopted for two reasons (However, ultimately the hybrid system currently in place was enacted). The Report states:

(a) The administrative and enforcement problems of the ultimate control approach are monumental. How is the assessor to learn when ultimate control of a corporation or partnership has changed? Moreover, when the rules are spelled out (and the Task Force actually drafted ultimate control statutes) it became apparent that, without trying to cheat, many taxpayers, as well as assessors, would simply not know that a change in ownership occurred. The separate entity approach is vastly simpler for taxpayers and assessors to understand, apply, and enforce. Transfers between individuals and entities, or among entities, will generally be recorded. Even if unrecorded the real property will have to be transferred (by unrecorded deed or contract of sale, for example). Taxpayers can justifiably be expected to understand that a transfer of real property is a change in ownership and must be reported to the assessor.

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**Tax Burden.** The Task Force expressed concern that a tax burden shift to residential taxpayers could occur under its separate entity theory since commercial and industrial property changes ownership less frequently than residential property. The definitions originally proposed for legal entities using the separate entity theory were chosen to mitigate administrative difficulties. Because of this concern, the Task Force proposed that the Legislature study the idea of a constitutional amendment to periodically appraise commercial and industrial property at current market value noting:

> [s]uch a constitutional change would also result in far greater simplicity in the treatment of legal entities. If commercial and industrial properties were to be periodically reappraised for reasons other than change in ownership, the difficult and controversial policy issues in choosing between the 'ultimate control' approach or 'separate entity' approach, outlined previously, would largely be avoided. The Task Force commends the principle of such a change to the Legislature for additional study.

In 1979, the initially codified change in ownership definitions for ownership interests in legal entities were based on the separate entity theory, as recommended by the Task Force. However, thereafter, subdivision (c) of section 64 was added to provide that a change in ownership occurs whenever there is a change in control by a transfer (or transfers) of more than 50 percent of the total ownership interests to a single person or entity.

According to the Assembly Revenue and Taxation Committee's Implementation of Proposition 13, subdivision (c) of section 64, "the majority-takeover-of-corporate stock" provision was added "out of a concern that, given the lower turnover rate of corporate property, mergers or other transfer of majority controlling ownership should result in a reappraisal of the corporation's property - an effort to maintain some parity with the increasing relative tax burden of residential property statewide, due to more rapid turnover of homes. It was also a trade-off for exempting certain transfers among 100 percent wholly-owned corporations."²⁶

**Change in Ownership Tracking.** RTC section 255.7 requires the county recorder to provide the assessor with a copy of an ownership transfer document as soon as possible when a change in ownership is recorded. Assessors discover most real property changes in ownership via grant deeds or other documents recorded with the county recorder. However, real property owned by a legal entity may undergo a "change in ownership" with no grant deed or other document recorded that could alert the assessor to a reassessment. These types of changes in ownership are self-reported directly to the BOE by the entity involved.

**LEOP.** As noted previously, it is difficult for property tax administrators to independently discover reassessable events involving legal entities because ordinarily there is no recorded deed or notice of a transfer of an ownership interest in a legal entity. Because of these difficulties, the law requires the BOE to participate in the discovery of changes in ownership and changes in control of legal entities under Section 64(c) – (d).²⁷

The BOE participates in this discovery through a program called the Legal Entity Ownership Program (LEOP). Under the LEOP, which started in January 1983, the BOE:

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²⁶ Section 64(b) excludes transfers of ownership interests between affiliated corporations and section 62(a)(2) excludes transfers which result in a change in the method of holding title to real property while the proportional ownership interests remain unchanged.

²⁷ Chapter 1141 of the Statutes of 1981 (AB 152).

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• Receives a list of legal entities from the Franchise Tax Board (FTB) that have reported a change in control or change in ownership on their income tax returns.
• Monitors business publications, such as *Mergers & Acquisitions* and the Wall Street Journal.
• Receives referrals from assessors as a result of information obtained in local publications or business property statement filings.
• Sends a LEOP COS called the "Statement of Change in Control or Ownership of Legal Entities" to each entity that might have experienced a change in control or ownership.
• Analyzes completed LEOP COSs to determine whether there has been a change in control or ownership.
• Notifies county assessors of changes in control and ownership.

**Annual Canvassing.** Section 64(e) requires an annual canvassing of legal entities via the state income tax return. The FTB transmits to the BOE the names and mailing addresses of the legal entities that report a change in control and/or a change in ownership on the income tax return for further investigation. The BOE makes a written request to the legal entity to file a LEOP COS to determine if it experienced a change in control or ownership or it obtained control of another entity that owned real property in California requiring reassessment.

The BOE also makes formal written requests to legal entities to investigate other possible changes in ownership based on information obtained from monitoring business publications and local assessors and interested parties' referrals. Additionally, at the local level, businesses are canvassed via the annual business property statement filed with the local assessor.

**Consequences of Ultimate Discovery.** Generally, the statute of limitations in section 532 limits escape assessments to either four or eight years for prior tax years. But due to concerns with intentional concealment of legal entity changes in ownership, provisions enacted in the late 1990's removed the statute of limitations to ensure there would be no financial advantage to concealing the event. Thus, section 532(b)(3) requires that an escape assessment be made for every tax year a legal entity fails to file the change in ownership statement required by section 480.1 for a section 64(c) change in control, or section 480.2 for a section 64(d) change in ownership.

### Guide to Change in Ownership Reporting Statutes

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<td>• LLC – Form_568 - Question J</td>
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<tr>
<td></td>
<td>• Filed with FTB</td>
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<td>• FTB transmits information to BOE</td>
<td></td>
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<tr>
<td>480</td>
<td>Change in Ownership Statement (COS)</td>
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</tr>
<tr>
<td></td>
<td>• Transfers of Real Property</td>
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</tr>
<tr>
<td></td>
<td>• Filed with local county assessor</td>
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</table>

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2005  | **SB 17** (Escutia)  
As Introduced  
12/06/04  | Every 3 years reassess property owned by publicly traded companies  
(rebuttable presumption).  
Property owned by other types of legal entities reassessed in proportion  
to the percentage of ownership interests in the legal entity transferred.

2003  | **SB 17** (Escutia)  | Legislative intent to redefine change in ownership for nonresidential  
commercial and industrial property.

2003  | **SBx1 3** (Escutia)  | Legislative intent to redefine change in ownership for nonresidential  
commercial and industrial property.

2002  | **SB 1662** (Peace)  | Reassess nonresidential property when cumulatively more than 50  
percent of ownership interests transfer.  
Broaden the state and local sales and use tax base and reduce both the  
state and local sales and use tax rate. (Legislative intent)

2001  | **AB 1013** (Leonard)  | Reassess when more than 50 percent of ownership interests transfer.

2000  | **AB 2288** (Dutra)  | Every 3 years reassess legal entity owned property. (Rebuttable  
premise change in ownership occurred.)  
Possible income tax credit to homeowners based on fair market value of  
homes from additional revenue.  
Reduce the sales and use tax rate by 0.25 percent.

1992  | Prop. 167  | Failed 41.16 percent - 58.84 percent  
Among various tax related items, included a provision to modify legal  
entity change in ownership definitions.  
Proponent: California Tax Reform Association

1991  | **SB 82** (Kopp)  | Reassess when cumulatively more than 50 percent of ownership interests  
transfer.

**Commentary:**

1. **Author’s Statement.** Senate Bill 1237 proposes to create a new "change in ownership" event for  
legal entity owned real property that occurs when 90 percent or more of the direct or indirect  
ownership interests in that legal entity transfer in a planned single transaction. Excludes family  
transfers upon death and publicly traded stock transactions. Increases penalties from 10 percent  
to 15 percent of taxes due for failure to file a legal entity change in control statements with the  
BOE.\(^8\)

2. **This bill requires assessors to reassess property following events that currently may not  
trigger a reassessment.** A new change in ownership triggering event is created to address cases  
in which the sellers of the legal entity transfer shares as part of a "single transaction" even if no  
one person or entity obtains control. Currently, "control" by one person is required to trigger  
reassessment. This bill primarily addresses the ability of persons to break up ownership into  
multiple legal entities to avoid reassessment (it also addresses the fact that married couples are  
not currently treated as a single unit). Two presumptions are created (discussed below) to help  
determine when shares have sold as part of a "single transaction."

3. **Reassessment examples.** Under this bill, reassessment may be required in the following  
situations where a company or business has real estate holdings:

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\(^{8}\) [http://district36.cssrc.us/content/my-legislation](http://district36.cssrc.us/content/my-legislation)

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to be construed to reflect or suggest the BOE’s formal position.
• A married couple buys a company with real estate holdings. (Under current law, ownership of the company is considered to be held 50/50 with neither spouse in control. Thus, this transfer does not meet the "change in control" test.)

• A company's current managers or employees buy the company from the retiring owners and no one person acquires control.

• A business (with no one in control) buys a competitor's business.

• A business (with no one in control) buys a supplier

4. A "planned" transaction. This bill appears more limited than similar legislation introduced in recent years in that the "single transaction" definition now requires the existence of a plan. (See section 64(c)(1)(B)(ii)(IV).) The plan requirement raises numerous uncertainties for tax practitioners and administrators. What conditions rise to the level of a plan?

• Does a plan require a detailed written document (or oral guidance) developed by expert counsel hired by the buyer to structure a non-reassessable transaction?

• Does a plan require the consensual agreement of both the buyer and the seller?

• If there is no coordinated plan by the transferors to sell, is the definition met? For example, when two partners sell their interests to unrelated transferees over a 36-month period (one partner retires) and 24 months later the other needs to liquidate for an unrelated reason, is this reassessable?

5. The rebuttable presumption. This bill also differs from prior legislation in that it adds a rebuttable presumption element. (See section 64(c)(1)(B)(ii)(IV).) Generally, a rebuttable presumption is an inference that, in the absence of any evidence to the contrary, is to be made and accepted as an established fact. The presumption permits (but does not require) the BOE or county assessor to assume that certain sales or transfers are part of a single transaction when, in fact, they may not be. Usually presumptions are created for administrative convenience. However, if the BOE or county assessor chooses to investigate the transaction, the presumption may be rebutted by a review of other evidence. Where contradictory evidence exists the presumption may be overcome.

6. Rebutting the presumption. As noted above, the BOE or assessor could choose to assert single transaction status without further investigation when either of the two conditions is met. If the taxpayer challenged the presumption, what evidence must the taxpayer present? More important, what precisely is being rebutted? Will they rebut that any pre-conceived plan existed or was contemplated? How could the taxpayer rebut a negative? Do they rebut that multiple transfers occurring on different dates were not "part of a plan" or that they were not "transferred in a single transaction?" For example, if the taxpayer planned for two transfers that fell under the 90 percent threshold, and a third unexpected transfer occurred within 36 months pushing the transaction over the threshold, do they rebut by claiming that the third transfer was not part of the plan or not part of an original "single transaction?"

7. Discretion. The bill appears to give both BOE and the assessor substantial discretion in change in ownership findings, such as the discretion to assert that a plan existed, and with respect to the evidence necessary to rebut the presumption. Is a conversation with the buyer enough for the BOE or assessor to rebut the presumption? These ambiguities could lead to inconsistent
administration in the counties. What if the BOE and assessor disagreed over a LEOP CIO finding? Assessors can independently process a LEOP CIO.

8. **Related Transferees – Open Ended.** The related transferee provision does not have any time frame. (See section 64(c)(1)(B)(ii)(IV)(ia).) Is it intended to be open ended (more than 36 months), or, is it intended to be limited to a single, non-cumulative transaction? Would a parent’s plan to transfer 5 percent a year to children over a long term trigger reassessment once the 90 percent or more threshold is reached?

9. **Spouses and Siblings – Single Unit.** Currently, interests owned by spouses are not treated as a single unit. This bill alters this longstanding rule. Furthermore, sibling interests would be treated as a single unit. Multiple generations would also be treated as a single unit: grandparent, parent, grandchild.

10. **Who are related transferees?** Under the federal law that this bill cross references, the following persons are considered related taxpayers. (26 U.S.C. section 267(b).)

   • Members of a family: the family of an individual shall include only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants; and

   • An individual and a corporation of which more than 50 percent in value of the outstanding stock is owned, directly or indirectly, by or for such individual;

   • Two corporations that are members of the same controlled group

   • A grantor and a fiduciary of any trust;

   • A fiduciary of a trust and a fiduciary of another trust, if the same person is a grantor of both trusts;

   • A fiduciary of a trust and a beneficiary of such trust;

   • A fiduciary of a trust and a beneficiary of another trust, if the same person is a grantor of both trusts;

   • A fiduciary of a trust and a corporation of which more than 50 percent in value of the outstanding stock is owned, directly or indirectly, by or for the trust or by or for a person who is a grantor of the trust;

   • A person and an organization to which section 501 (relating to certain educational and charitable organizations which are exempt from tax) applies and which is controlled directly or indirectly by such person or (if such person is an individual) by members of the family of such individual;

   • A corporation and a partnership if the same persons own:

     o more than 50 percent in value of the outstanding stock of the corporation, and

     o more than 50 percent of the capital interest, or the profits interest, in the partnership;

   • An S corporation and another S corporation if the same persons own more than 50 percent in value of the outstanding stock of each corporation;

   • An S corporation and a C corporation, if the same persons own more than 50 percent in value of the outstanding stock of each corporation; or

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• Except in the case of a sale or exchange in satisfaction of a pecuniary bequest, an executor of an estate and a beneficiary of such estate.

11. **Under current change in ownership definitions, when companies (i.e., legal entities) are purchased or otherwise acquired, whether their real property is reassessed to current market value generally depends on whether there is a change in control.**

**Scenario 1 (Control):** If one legal entity or person buys 100 percent of the ownership interests in another legal entity, then absent an exclusion, the law requires a **reassessment** of all the real property owned by the acquired legal entity. Since the acquiring legal entity or person obtains more than 50 percent of the ownership interest in the acquired legal entity under Section 64(c), this is a "change in control."

**Scenario 2 (No Control):** If three different legal entities or persons buy 100 percent of the ownership interests in that same legal entity in equal shares, there is **no reassessment.** In this scenario, each new buyer only has a 33 1/3 percent ownership interest in the acquired legal entity and no one entity or person has control.

In both scenarios, the acquired legal entity has entirely new owners, but only Scenario 1 results in reassessment.

<table>
<thead>
<tr>
<th>DATE</th>
<th>TRANSACTION</th>
<th>REASSESSMENT</th>
</tr>
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<tbody>
<tr>
<td>5/1/16</td>
<td><strong>Scenario 1</strong>&lt;br&gt;Established Company (EC) <strong>buys 100% of the ownership interests</strong> in Startup Company (SC)&lt;br&gt;SC owns 5 properties in various locations in California&lt;br&gt;SC purchased properties in 2000, 2002, 2005, 2008, 2012</td>
<td><strong>EC Obtains Control of SC</strong>&lt;br&gt;Reassess all 5 properties to market value on May 1, 2016.</td>
</tr>
<tr>
<td>5/1/16</td>
<td><strong>Scenario 2</strong>&lt;br&gt;Three Venture Capitalists (VC₁, VC₂, VC₃) <strong>buy 100% of the ownership interests</strong> in SC in equal shares.</td>
<td><strong>Neither VC₁, VC₂, or VC₃ singularly control SC: each have 33 1/3%</strong>&lt;br&gt;No Reassessment of any SC-owned property&lt;br&gt;The 5 properties retain the assessed value established at the time acquired by SC</td>
</tr>
</tbody>
</table>

12. **New Change in Ownership Trigger Point.** This bill adds a new reassessment trigger event with respect to transfers of ownership interests in legal entities. Properties will be reassessed whenever 90 percent or more of a legal entity's ownership interests are transferred. Currently, only if a transfer of ownership interests causes a "change in control" of the legal entity (i.e., pushing one person (or legal entity) up and over the 50 percent ownership interest threshold) is the property owned by that legal entity reassessed to its current value. This bill changes the law to require reassessment of Startup Company's five properties in the Scenario 2 transaction discussed above.

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13. This bill attempts to treat the transfer of ownership interests in legal entities more like the transfer of real property interests. Any transfer of real property interests results in a change in ownership, absent an applicable exclusion, while transfers of ownership interests in a legal entity do not result in a change in ownership of property owned by the legal entity unless Section 64(c)(1) or (d) are triggered. (See section 64(a).) The following illustrates the disparate treatment:

- **Transfer of Real Property Interest.** Four individuals each own a 25 percent interest in a property. Each sale of an individual's 25 percent interest in the property triggers a 25 percent reassessment. (ABCD to EFGH)

- **Transfer of Ownership Interest in Legal Entity.** If the same property is owned by a legal entity in which the same four individuals each own a 25 percent interest, a sale of an individual's 25 percent interest in the legal entity will not cause a reassessment of the property owned by the legal entity. This is true even if there is a complete turnover of ownership interests in a single event. Only if one person obtains control (defined as ownership interests of more than 50 percent) of the legal entity is reassessment triggered. (ABCD to EFGH)

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<tr>
<th>Progression of Transactions</th>
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<th>Owners After Transfer</th>
<th>Percent Reassessed if Real Property Interests Transfer Under Current Law</th>
<th>Percent Reassessed if Legal Entity Ownership Interests Transfer Under Current Law</th>
<th>Percent Reassessed if Legal Entity Ownership Interests Transfer Under SB 1237</th>
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<td>A sells 25% to E B sells 25% to F C sells 25% to G D sells 25% to H</td>
<td>01/01/19</td>
<td>EFGH</td>
<td>100%</td>
<td>0%</td>
<td>100%1</td>
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<tr>
<td>E sells 25% to I</td>
<td>04/05/19</td>
<td>FGHI</td>
<td>25%</td>
<td>0%</td>
<td></td>
</tr>
<tr>
<td>F buys G's 25% F buys H's 25%</td>
<td>09/10/20</td>
<td>FI 75%/25%</td>
<td>50%</td>
<td>100%2</td>
<td>100%2</td>
</tr>
<tr>
<td>F buys I's 25%</td>
<td>10/15/21</td>
<td>F</td>
<td>25%</td>
<td>0%3</td>
<td></td>
</tr>
<tr>
<td>F sells 50% to J</td>
<td>12/30/22</td>
<td>FJ</td>
<td>50%</td>
<td>0%4</td>
<td></td>
</tr>
<tr>
<td>F sells 50% to K</td>
<td>01/30/23</td>
<td>JK</td>
<td>50%</td>
<td>0%</td>
<td>100%5</td>
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</tbody>
</table>

1. **All New Owners – But No One in Control.** Transfer of 100 percent of ownership interests. This bill's new change in ownership trigger point results in reassessment. Property reassessed to its market value on January 1, 2019.

2. **Change in Control.** On September 10, 2020, F acquires "control" of the legal entity; F now owns 75 percent of the legal entity's ownership interests. Current law requires a 100 percent reassessment of the property to its value on September 10, 2020.

3. **No Change in Control.** F owns 100 percent of the legal entity as of October 15, 2021. But, since F previously obtained control of the legal entity on September 10, 2020. No reassessment under current law.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.
4. **Loss of Control.** F owns 50 percent and J owns 50 percent. No one controls the legal entity. While F has lost control, no one gained control. No reassessment.

5. **Cumulative Transfer.** 100 percent of the ownership interests are cumulatively transferred. Property reassessed to its fair market value on January 30, 2023.

   This bill provides that when 90 percent or more of the ownership interests in the legal entity transfer in a single transaction that occurs on or after January 1, 2019, a change in ownership of the legal entity will occur, resulting in reassessment of property owned by it.

   The disparate treatment between ownership interests in real property and legal entities is illustrated in columns 4 & 5 of the table above. Column 6 shows this bill’s reassessment consequences when legal entity ownership interests transfer. (Note: Only the first and last transfers that take place on January 1, 2019, and January 30, 2023, respectively, reflect the changes made by this bill. The other transfer examples reflect existing law.)

14. **Is the transfer of ownership interests in legal entities without reassessment consequences unintentional?** The Proposition 13 Task Force debated the issue of how to treat sales and transfers of legal entity ownership interests. The Task Force recognized the potential long term effect of the original definitions noting "(t)he Task Force admits that some of its own recommendations, such as those regarding legal entities, while the best of a seemingly 'no-win' choice of options and adopted to mitigate administrative difficulties, may, in the long run, further exacerbate this [tax burden] shift to residential property because it will result in fewer potential commercial and industrial property transfers being recognized for reappraisal purposes." Consequently, the Task Force proposed that the Legislature later consider a constitutional change to periodically reappraise commercial and industrial property. In 2012, Assembly Member Ammiano introduced AB 2014 to create a new task force to study this issue. After nearly 35 years, this bill seeks to add a new definition to those initially created to cause more frequent reassessment when property is owned by a legal entity.

15. **This bill addresses ownership interests in legal entities that are transferred indirectly to another legal entity or person.** With sufficient planning and legal advice under current law, it might have been possible to structure transactions that transfer property via a legal entity to new owners indirectly using multiple tiers of legal entities and minimize or preclude reassessment under the new change in ownership trigger. As such, this bill includes indirect ownership transfers and provides that indirect ownership interests should be proportionately counted.

   However, as currently written, there is a potential inconsistency surrounding the phrase "including the real property owned by legal entities under its control," in section 64(c)(1)(B)(i). For example, if Company A, which is owned 60 percent by Company B, purchases real property, and Company B undergoes a 95 percent transfer of ownership interests, section 64(c)(1)(B)(i) states that the real property owned by Company A, which was under the control of Company B pursuant to the definition of "control" in section 64(c)(1)(B)(ii)(l), would undergo a 100 percent change in ownership reassessment. However, under section 64(c)(3), only 60 percent of the property would be reassessed in this scenario because the indirect ownership interest would be measured proportionately.

16. **This bill affects all types of real property owned by a legal entity.** This bill does not differentiate between residential and commercial property. All types of real property owned by a legal entity (partnerships, limited liability companies, corporations, etc.) are subject to the new triggering
event. Thus, this bill could impact single family homes, multi-family properties (such as apartments, duplexes and mobilehome parks), agricultural property, family farms, and small businesses.

17. **Counting Legal Entity Interest Transfers.**

18. **Change in Ownership Exclusions.** This bill provides that when 90 percent or more of the direct or indirect ownership interests in a legal entity are sold or transferred in a single transaction, the purchase or transfer of the ownership interests results in a change in ownership of the real property owned by the legal entity, including the real property owned by legal entities under its control, whether or not any one legal entity or person that is a party to the transaction obtains control, except when the sale or transfer qualifies for an exclusion from change in ownership under any other law or does result in a change in ownership under any other law. Does the author intend to apply the change in ownership exclusions for transfers of real property to transfers of interests in legal entities? RTC section 63.1, which contains the parent-child and grandparent-to-grandchild exclusions, specifically provides in section 63.1(c)(8) that this exclusion does not apply to transfers of interests of legal entities, other than a transfer of an interest of a unit or lot within a cooperative housing corporation, a pro rata ownership interest in a tenant-owned mobilehome park, or a pro rata interest in a floating home marina.

19. **Williamson Act property.** In practical application, Williamson Act property and other property under contract and eligible for special assessment provisions (such as the Mills Act for historical property) will not be impacted *provided* the property remains under contract. The law requires these properties to be assessed at the *lowest* of three specified values. While a new base year value would be reset if a change in ownership occurs under the new trigger, this value would likely be greater and will not become the basis of assessed value.

20. **Floating Homes.** Manufactured homes that are not on permanent foundations are classified as personal property pursuant to section 5801(b)(2). However, they are treated as real property in that they are reassessed upon a change in ownership or completion of new construction and receive a base year value pursuant to section 5802. Floating homes are in a similar situation in that they are treated differently for property tax purposes. Section 229 provides that floating homes are not vessels, but are treated as real property for property tax assessment purposes. Under RTC section 480, whenever a change in ownership of real property, a manufactured home, or a floating home occurs, the transferee must file a change in ownership statement with the county assessor. When the assessor requests a transferee file a change in ownership statement and the statement is not filed timely, a penalty is imposed pursuant to section 482(a). This bill removes floating homes from this penalty requirement. This would create an inequity between sections 480 and 482 in that transferees of floating homes are required to file a change in ownership statement, but no penalty would be imposed if a transferee refuses to file upon an assessor's request. We recommend that the penalty requirement for floating homes remain in section 482(a).

21. **Regulations.** This bill requires the BOE to prescribe regulations as may be necessary to carry out the bill's purposes. The BOE already has this authority pursuant to Government Code section 15606(c). Property Tax Rule 462.180 clarifies changes in ownership of legal entities.

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9 The parent-child change in ownership exclusion does not apply to transfers of ownership interests in legal entities, except to the extent the *uncodified note* of Section 63.1 is followed [Section 2 of Stats. 1987, Ch. 48 (AB 47), as amended by Section 6 of Stats. 2006, Ch. 224 (SB 1607)].

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22. **BOE implementation and revenue impact report to the Legislature.** This bill requires the BOE to report the revenue impact and frequency of reassessments resulting from the new change in ownership trigger by January 1, 2021. However, the BOE does not obtain assessed value changes of properties owned by legal entities. To gather this data, assessors must track and report to the BOE the necessary data once the assessor completes the reassessment of the properties owned by the legal entity.

Additionally, the information obtained by January 1, 2021 will not reflect reassessments that occur in a 36 month period as set forth in section 64(c)(1)(B)(ii)(IV)(ib), because only 24 months will have transpired.

23. **What is a "split roll?"** Typically, the term "split roll" means taxing various property types (for example, residential v. commercial) according to a different tax rate or value standard. In the context of reassessment of legal entity owned property, some use the term to reference modifying the change in ownership provisions related to legal entity ownership interests to trigger more frequent reassessment, such as this bill proposes. A true "split roll" is not possible without a constitutional amendment.

24. **Modifying "Change in Ownership" provisions.** While Proposition 13 amended the Constitution to provide that a "change in ownership" triggers reassessment, it did not define the phrase. Statutory language defines the term and specifies transfers included or excluded from a change in ownership. Thus, statutory amendments modifying the original statutory definitions are permissible.

**Costs:** The BOE's cost to administer this bill is pending. Legal entity changes in ownership are complicated. This bill represents the first substantive change to legal entity change in ownership law since the initial definitions were crafted. This bill requires new regulations; changes to existing regulations, handbooks, taxpayer guidance materials, change in ownership reporting forms and instructions; and an additional question on the state income tax return. Furthermore, currently relied upon annotated letters on legal entity change in ownership law will not always be relevant. Additional resources will be needed to research, study, and answer new opinion requests from within the agency, the counties, and taxpayers. Under this bill, since an ownership interest is not counted again once it has been counted to determine whether a change in control or ownership of a legal entity has occurred, assessors and the BOE would be required to search for and identify all previous ownership transfers in order to verify whether the interest transferred had already been counted. Additionally, the existing LEOP database may need to be updated to track the percentage interested transferred in order to ensure the 90 percent threshold is enforced and double counting does not occur. For the Legislative report, the BOE would need to coordinate with each county assessor's office since the BOE does not currently obtain any value information on properties affected by a change in control or ownership, to track the bill's revenue impact as required.

**Revenue Impact: Background, Methodology, and Assumptions.** Existing property tax law specifies a change in ownership occurs when a legal entity or other person obtains a controlling or majority ownership interest in the legal entity. SB 1237 requires real property owned by a legal entity be reassessed whenever 90 percent or more of the ownership interests in that legal entity are sold or transferred in a single transaction. "Single transaction" means a plan consisting of one or more sales or transfers of ownership interests on or after January 1, 2019, including those that occur within a 36-month period, as defined. The bill subjects real property owned by legal entities to reassessment
more often than under current law. The result is an increase in assessed value and an increase in property tax revenue.

Estimating the revenue increase is difficult, as we do not know how many times such transactions occur in California. However, based on a recent sample of county assessment roll data, staff estimates 2017-18 legal entity assessed values to be $1.052 trillion.

Each year, the Board conducts a study to determine the effective assessment level (i.e., the percentage difference between assessed value and market value) for commercial/industrial property in order to determine the assessment level for rail transportation property (the 4R Ratio). The latest study, based on the 2016-17 assessment roll, finds the effective assessment level is about 61 percent. Applying this ratio to the estimated legal entity-owned assessed value, we estimate current legal entity market value to be:

\[
\frac{1.052 \text{ trillion}}{61 \text{ percent}}, \text{ or } 1.725 \text{ trillion}
\]

While it is difficult to predict the annual number of legal entity property reassessments under SB 1237, staff used the aforementioned 4R Ratio study to determine the rate of transfer of all commercial property. Our study suggests four percent of commercial properties on average are subject to reassessment each year to current market value. Assuming legal entities track closely with the commercial property rate of transfer, the revenue impact at the basic one percent property tax rate is:

<table>
<thead>
<tr>
<th>Estimated Legal Entity Assessed Value</th>
<th>Estimated 4R Ratio</th>
<th>Estimated Legal Entity Market Value</th>
<th>Estimated Increase in Assessed Value</th>
<th>Estimated Annual Rate of Transfer</th>
<th>Estimated Annual Revenue Gain at the Basic 1 percent Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1.052 trillion</td>
<td>61 percent</td>
<td>$1.725 trillion</td>
<td>$673 billion</td>
<td>4 percent</td>
<td>$269 million</td>
</tr>
</tbody>
</table>

This bill would also increase the penalty from 10 percent to 15 percent of taxes due for failure to file legal entity change in control statements with the Board. According to the Board’s County-Assessed Properties Division, transactions subject to this penalty are minimal, historically not more than 10 percent of all filings. Assuming an average assessed value for property owned by legal entities to be $300,000, we estimate the revenue impact of increasing the failure to file penalty to be less than $1 million annually. This amount may decrease over time as the increased penalty becomes a deterrent to late filing.

Revenue Summary: Based on the preceding assumptions, the annual revenue gain could amount to about $269 million.

Qualifying remarks: The revenue estimate is based on limited county roll data. It gives an indication of the order of magnitude of the revenue impact of SB 1237. The impact will vary from year to year depending upon the number of annual transactions and the value of properties owned by a legal entity.

This revenue estimate does not account for any changes in economic activity that may or may not result from enactment of the proposed law.

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