STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE ENROLLED BILL ANALYSIS

Date Amended:	**Chapter 622**	Bill No:	**SB 816**
Tax:	**Property**	Author:	**Ducheny**
Related Bills:			

BILL SUMMARY

Related to change in control and change in ownership reporting requirements for legal entities that own California real property, this bill would:

- Establish a penalty when a legal entity does not self report a change in control or change in ownership occurring under Section 64(c) or (d) to the Board of Equalization (Board) within 45 days of the event. *§§480.1, 480.2, and 482*
- Eliminate automatic penalty abatement when a legal entity fails to respond to a Board written request to file a legal entity change in ownership statement. *§§482 and 483*

Related to the locally imposed documentary transfer tax, this bill would:

- Authorize the assessor to provide confidential information to the county recorder for purposes of investigating whether the documentary transfer tax should be imposed. *§408*
- Expressly authorize county board of supervisors to establish an administrative appeal process and specify that the value determined for purposes of the documentary transfer tax is not binding on the value determined for property tax purposes. *§11935*

ANALYSIS

CHANGE IN OWNERSHIP – PROPERTY OWNED BY LEGAL ENTITIES
Revenue and Taxation Code Section 64

CURRENT LAW

Under existing property tax law, real property is reassessed to its current fair market value whenever there is a "change in ownership." (*Article XIII A, Sec. 2; Revenue and Taxation Code Sections 60 - 69.5)*

Revenue and Taxation Code Section 64 sets forth the change in ownership provisions related to the purchase or transfer of ownership interests in legal entities that own real property (e.g., stock in a corporation, interests in a limited liability company, or interests in a partnership). Section 64(a) provides the general rule that transfers of interests in legal entities do not constitute changes in ownership (and, therefore, no reassessments) of the real property owned by those legal entities. However, there are two exceptions to that general rule. The first exception is when there is a "change in control" of the legal entity. The second exception is when persons that are deemed "original coowners" of the legal entity cumulatively transfer more than 50 percent of their ownership interests in that legal entity. Specifically:

- **Change in Control of Legal Entity.** Section 64(c) provides that when any person or entity obtains control through direct or indirect ownership or control of **more than 50 percent** of the voting stock of a corporation, or of more than a 50 percent ownership interest in any other type of legal entity, a reassessment of any and all the real property owned by the acquired legal entity (and any of its subsidiaries) as of the date of the change in control occurred.
- **Cumulative Transfers by "Original Coowners**." Section 64(d) provides that when voting stock or other ownership interests representing **cumulatively more than 50 percent** of the total interests in a legal entity are transferred by any of the "original coowners[1]" in one or more transactions, the real property which was previously excluded from change in ownership under Section 62(a)(2), shall be reassessed.

PROPOSED LAW

This bill would not modify change in ownership definitions as they relate to property owned by legal entities. However, it would strengthen reporting requirements and penalties in order to aid in the discovery of properties that should be reassessed under the *existing* change in ownership definitions.

CHANGE IN OWNERSHIP DISCOVERY
Revenue and Taxation Code Sections 480.1 and 480.2

CURRENT LAW

Revenue and Taxation Code Section 255.7 requires that whenever a change in ownership is recorded, the county recorder must provide the assessor with a copy of the transfer ownership document as soon as possible. Assessors discover most changes in ownership of real property via grant deeds or other documents that are recorded with the county recorder. However, with respect to property owned by a legal entity, the property may "change ownership" under the law, but no grant deed or other document is recorded that might alert the assessor that the property should be reassessed. Thus, discovery of these types of changes in ownership is dependent on self reporting by the legal entities.

Self Reporting. Existing law requires a change in ownership statement to be filed with the Board within 45 days of whenever a change in control or change in ownership of a legal entity under Section 64(c) or (d) occurs. However, no penalty is imposed if the statement is not filed within the 45 day period specified in law. In other words, while the law requires a legal entity to alert property tax administrators that the underlying ownership of the legal entity has changed to the point that a reassessment should take place, there is no consequence to the legal entity for not complying with this particular requirement. Rather, a penalty applies only if a legal entity does not timely respond to a direct Board request to file a change in ownership statement as described below.

---

[1] **Proportional Interests Exclusion Creates "Original Coowner" 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, 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 coowners**" for purposes of tracking subsequent transfers by them 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).

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 Board's formal position.

Who must file? 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 statement. Whereas, in the case of a change in ownership under Section 64(d), the legal entity is responsible for ensuring the statement is filed.

Board Requests. The law requires that the Board participate in the discovery of changes in ownership and changes in control of legal entities under Section 64(c) and (d) to help discover unreported changes in ownership and changes in control of legal entities. To this end, the primary method is an annual canvassing of legal entities via the state income tax return as required by Section 64(e). Additionally, at the local level, businesses are canvassed via the annual business property statement filed with the local assessor.

With respect to information from the state income tax return, the Franchise Tax Board transmits to the Board for further investigation the names and addresses of those legal entities that indicate it was involved in a change in control and/or a change in ownership. The Board then makes a formal written request to the legal entity to file a change in ownership statement to determine if property it owns in California should be reassessed. (The Board also sends statements to legal entities to investigate other possible changes in ownership based on information it obtains from monitoring business publications and referrals from local assessors.)

If a legal entity does not complete and file the requested statement within the stated time period, a penalty is applicable. The penalty for failure to respond to a Board written request to file a statement applies whether or not it is determined that a change in control or change in ownership actually occurred – the amount is either:

- 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, *or*
- If no change in control or change in ownership occurred, 10 percent of the current year's taxes on that property shall be added to the assessment made on the roll.

Consequences of Ultimate Discovery. While there is no penalty for failing to notify property tax administrators within the required 45 day period, there is, nonetheless, a long term consequence of not reporting reassessable events promptly. This is because Section 531.2(b) and 532(b)(3) provide that when it is eventually discovered that a property should have been reassessed pursuant to Section 64(c) or (d) and it was not reported, then the property must be reassessed as of the date of that event and all the back taxes (plus interest and a potential fraud penalty) must be repaid. Specifically, “escape assessments” are levied for every tax year in which the property owned by the legal entity was not assessed at the proper amount to reflect the change in ownership.

Generally, the statute of limitations provisions on escape assessments found in Section 532 limit escape assessments for prior tax years to either a four or eight year limit. But due to concerns with intentional concealment of legal entity change in ownerships, provisions were enacted in the late 1990’s to remove 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 when a legal entity fails to file the change in ownership statement, as 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.

PROPOSED LAW

This bill would amend Sections 480.1, 480.2, and 482(b) to provide that a penalty is to apply if the statement is not filed with the Board within 45 days of the ***earlier*** of:

- the date of the event triggering the reassessment (under Section 64(c) or 64(d)).
- the date the Board makes a written request to file a statement .

Thus, when there ***is*** a change in control or change in ownership, this means that a legal entity must file with the Board a change in ownership statement within 45 days of the event, with or without any written request being made by the Board, or a 10% penalty will be imposed.

Self Reporting. In practical application, this amendment serves to establish a penalty if a legal entity does not ***independently*** report a change in control or change in ownership to the Board within 45 days of the date of the event. The penalty would be 10% of the taxes applicable to each new base year value when the event is ultimately discovered.

Board Requests. This bill does not change the requirement to file a change in ownership statement after a written request by the Board. Nor does it change the associated penalties for failure to respond to a written request from the Board within 45 days. (But it does eliminate automatic penalty abatement from the Board as noted below under "Penalty Abatement.")

The Board will continue to make formal written requests to legal entities from potential leads it receives from the FTB annual canvassing process, from local assessors, and from business publications.

- If a change in control or change in ownership <u>did not</u> occur and the legal entity responds to the Board within 45 days – no penalty would be imposed.
- If a change in control or change in ownership <u>did</u> occur, and it was not previously self-reported, then the penalty would have already been triggered (because it was not reported within 45 days of the event).

PENALTY ABATEMENT
Revenue and Taxation Code Sections 482 and 483

CURRENT LAW

Automatic – Second Notice. Section 482(b) provides that the penalty for failing to file a statement will be automatically extinguished if the person or legal entity files a complete statement with the Board no later than 60 days after the date on which the person or legal entity is notified by the Board of the penalty.

Reasonable Cause. Section 483(c) sets forth the procedures for requesting penalty abatement when the reason for not filing a statement was due to reasonable cause and not due to willful neglect.

PROPOSED LAW

This bill would amend Sections 482(b) and 483 to delete the automatic extinguishment of the penalty for failure to respond if the legal entity files a complete statement within 60 days after being notified of the penalty. However, a legal entity could continue to seek penalty abatement for reasonable cause under Section 483 with the county board of supervisors.

DOCUMENTARY TRANSFER TAX AND COUNTY ASSESSORS
Revenue and Taxation Code Sections 408 and 11935

CURRENT LAW

The law requires that assessors keep certain information confidential. Section 408(a) contains the general confidentiality rule for county assessors, and provides that homeowners' exemption claims and any information and records in the assessor's office that are *not required*[2] by law to be kept or prepared by the assessor are not to be open to public inspection. In addition, Sections 451 and 481 provide that all information requested by the assessor or furnished in the property statement and change in ownership information shall be "held secret" by the assessor.

Subdivision (b) of Section 408 provides an exception to the general rule of confidentiality for certain governmental agencies or representatives. It requires that the assessor disclose information, furnish abstracts, or permit access to all records in his or her office to specified entities.

PROPOSED LAW

This bill would amend subdivision (b) of Section 408 to add the county recorder to the list of agencies that may have access to all records in the assessor's office for purposes of determining whether a documentary transfer tax is to be imposed. The documentary transfer tax is administered at the local level by the county recorder.

This bill would also add Section 11935 to the Revenue and Taxation Code to expressly provide for an administrative appeal process to resolve documentary transfer tax disputes. Section 11935(b) expressly provides that the value of property established for purposes of determining the amount of documentary tax due in the administrative appeal process or a subsequent lawsuit is not binding on the determination of the value of that property for property tax purposes by the county assessor, an assessment appeals board, or a court of law reviewing property tax values established by an assessment appeals board.

IN GENERAL

The Board's Legal Entity Ownership Program (LEOP) started in January 1983 as a result of Chapter 1141 of the Statutes of 1981 (AB 152). The resulting Sections 480.1 and 480.2 of the Revenue and Taxation Code require the Board to participate in the discovery of changes in control and ownership of corporations, partnerships, and other legal entities. It was recognized that such events, which are not evidenced by a recorded document, would fall outside the parameters of assessors' normal means for discovering changes in ownership. Independent discovery of these changes by property tax administrators is difficult because ordinarily there is no recorded deed or notice of a transfer of an ownership interest in a legal entity.

Under the LEOP, the Board:

- Receives a list from the Franchise Tax Board of legal entities 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.

[2] There are only very limited records that are required to be kept by the assessor, such as the roll and the list of transfers.

- Receives referrals from assessors as a result of information obtained in local publications or business property statement filings.
- Sends a "Statement of Change in Control or Ownership of Legal Entities" to each entity. http://www.boe.ca.gov/proptaxes/leop.htm
- Analyzes completed statements to determine whether there has been a change in control or ownership.
- Notifies county assessors of changes in control and ownership.

Guide to Change in Ownership Reporting Statutes

RTC Section	Subject *Click on link to view sample forms*
480	Change In Ownership Statement (COS)
480.1	BOE Change In Ownership Statement - Transfers of Legal Entity Interests • Legal Entity Ownership Program (LEOP): • Change In Control under §64(c)
480.2	BOE Change In Ownership Statement– Transfers of Legal Entity Interests • Legal Entity Ownership Program (LEOP) • Change In Ownership under §64(d)
480.3	Preliminary Change in Ownership Report (PCOR)
480.4	Preliminary Change in Ownership Report – Detail of Form
481	COS and PCOR – Confidentiality
482	Failure to File Penalties (§§480, 480.1, and 480.2)
483	Failure to File Penalties – Penalty Abatement

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the California Assessors' Association to ensure that legal entities properly report changes in control and ownership.
2. **Amendments**. The **August 31** amendments provide that the state will not reimburse counties pursuant to provisions for state mandated costs because counties have the authority to levy service charges, fees, or assessments sufficient to pay any increased cost incurred by this bill. The **June 26** amendments incorporated suggestions made in a prior Board analysis to make corresponding changes to Section 483. Related to penalty abatement, the Board would no longer have a direct role in penalty abatement since the automatic penalty abatement provisions are being eliminated. In addition, Section 482 was amended for clarity as suggested in the prior analysis.
3. **Changes in control or changes in ownership of a legal entity triggered due to transfers of ownership interests in legal entities (Section 64(c) and (d)) are not easy to discover.** Unlike transfers of interests in real property, a deed is not recorded with the county recorder nor is there any other type of public notice that the Board or the local assessor could use to monitor and track transfers of ownership interest in a legal entity.

4. **The law requires legal entities to report a change in control or change in ownership under Section 64(c) and (d) by filing a change in ownership statement within 45 days of the event, but there is no penalty for failure to do so.** Under current law, a penalty is incurred only if a legal entity does not respond to a written request by the Board to file a statement. Legal entities are given two opportunities to provide the information before a penalty is levied. This bill would impose a penalty on those legal entities that do not *initiate* filing a change in ownership statement within the required time period.

5. **As an aid in discovering change in control of legal entities or change in ownership of property owned by legal entities, the Board routinely sends statements to legal entities based on information from the property tax question on the state income tax return and from monitoring various business publications.** This bill would not modify the requirement to file a statement upon Board request and the penalty for failure to respond to the Board request for information. These penalties can apply whether or not a change in ownership actually occurred. However, this bill does eliminate the automatic penalty extinguishment provisions. As a result, the Board would not be required to send a penalty notice to those legal entities that do not respond to the Board's initial request along with a second request to file the statement and the request for automatic penalty abatement. Instead, the local assessor would send the penalty notice.

COST ESTIMATE

This Board would incur absorbable costs to modify the change in ownership statements and related documents for legal entities. In addition, there may be increased self reporting by legal entities resulting in more statements to process. Furthermore, in some cases, there may be some double reporting by legal entities if they both (1) self report and (2) report the event again at a future date via the state income tax return. Any double reporting of a single event would require additional processing.

REVENUE ESTIMATE

This measure has no direct revenue impact. Establishing a penalty for not self-reporting and filing a change in ownership statement with the Board may be an incentive for legal entities to properly file a change in ownership statement when a change in ownership occurs.

Analysis prepared by:	Rose Marie Kinnee	916-445-6777	09/15/09
Contact:	Margaret S. Shedd	916-322-2376	

ls 0816-enr.doc

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 Board's formal position.