STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**05/22/03**	Bill No:	**SB 17**
Tax:	**Property**	Author:	**Escutia**
Board Position:		Related Bills:	**SB 3x (Escutia)** **ACA 16 (Hancock)**

BILL SUMMARY

This bill would:

- Require the Franchise Tax Board to furnish the Board of Equalization (Board) with the name and address of any entity that does not respond to a question concerning change in ownership on partnership, bank, and corporate tax returns. *§64*
- Require publicly traded companies to file annual real property statements with the Board and impose penalties for failure to file the statement. *§471*
- Modify and increase the penalty assessed when a legal entity does not file a change in ownership statement with the Board after a change in ownership under Section 64, subdivisions (c) and (d) due to a change in control of the legal entity. *§480.1, §480.2 and §482.*
- Make various legislative findings and declarations related to change in ownership of nonresidential commercial and industrial property.

Summary of Amendments

The amendments since the prior analysis (1) provide that penalties levied for failure to file change in ownership statements would be added to the assessment roll, as current law provides (the penalties would have previously been deposited with the Board), (2) provide that if a publicly traded company makes a reasonable error or omission on the real property statement, the penalty for failure to provide a complete statement would not be imposed, and (3) specify the annual date, December 31, as of which real property holdings for the year would be reported the following March 1.

ANALYSIS

Current Law

A. Change In Ownership Definitions

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

Revenue and Taxation Code Section 60 defines a "change in ownership" to mean a transfer of present interest in real property including the beneficial use thereof, and the value of which is substantially equal to the value of the fee interest.

Revenue and Taxation Code Section 64 sets forth the change in ownership provisions related to the purchase or transfer of **ownership interests <u>in</u> legal entities** that own real property. Generally, when real property is owned by a legal entity, the purchase or transfer of ownership interests in that legal entity does not trigger a change in ownership of the property.

An exception to this general rule is when there is a **"change in control"** of the legal entity or upon the transfer of more than 50% of "original coowners" interests. Subdivision (c) of Section 64 generally provides that a "change in control" occurs when **one person** or legal entity **acquires more than 50 percent** of the ownership interests in the legal entity. Subdivision (d) of Section 64 provides that if real property was excluded from a change in ownership when transferred into a legal entity under Section 62(a)(2) and the holders of the ownership interests became "original coowners" the subsequent transfer of more than 50% of those original co-owner's shares are transferred results in a change in ownership of the real property that was previously excluded.

B. Change in Ownership Reporting

Under existing law Sections 480.1 and 480.2 require a change in ownership statement to be filed by a legal entity when a change in ownership occurs under Section 64(c) or 64(d). Section 482 outlines penalties to be charged if the statement is not filed within 45 days of a written request by the Board. The penalty 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, *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.

However, the penalty is automatically extinguished if the person or legal entity files a complete statement described in Section 480.1 or 480.2 no later than 60 days after the date on which the person or legal entity is notified of the penalty.

To help discover changes in control of legal entities, information is requested on the state income tax return as required by subdivision (e) of Section 64. The Franchise Tax Board provides the information provided by taxpayers on the tax return form to the Board.

Proposed Law

A. Change In Ownership Definitions

The legislative findings and declaration would state that because of difficulties in identifying changes in ownership of certain nonresidential commercial and industrial properties, these properties often escape reassessment at full market value upon a change in ownership.

B. Change in Ownership Reporting

Publicly Traded Companies. This bill would add Section 471 to the Revenue and Taxation Code to require publicly traded companies (except for state assessees) to file annual real property statements with the Board by March 1 of each year. The statement would list all of the real property owned or leased in California, by county, as of December 31 of the prior calendar year. The property would be identified by assessor parcel number. If a company does not file a statement that contains all of the required information by April 15, then a 10% penalty based on the current year's taxes on all of the real property owned by the company in the state would be levied. After the first statement is filed, subsequent statements would be limited to property that has been transferred during the immediately preceding calendar year. The Board would transmit any relevant information contained in the statement to the assessors of the counties in which the property is located.

All Legal Entities. This bill would amend Section 480.1, 480.2 and 482 to modify the requirements and penalties for legal entities to file a change in ownership statement with the Board after a change in ownership under Section 64(c) and (d) due to a change in control of the legal entity. Specifically, it would:

- Extend from 45 to 60 days the number of days to file a statement upon a change in ownership and delete provisions for a second notice prior to the levy of the penalty.
- Require statements to list assessor parcel numbers of affected properties.
- Delete provisions requiring statements upon demand of the Board.
- Delete automatic abatement of penalty if information is ultimately provided.
- Change the penalty from 10% of current year's taxes to the greater of 10% of current year's taxes on all of the real property owned by the legal entity in each applicable county or $10,000. The penalty would be added to the assessment roll.
- Create a new penalty of greater than 25% of the current year's taxes on all real property owned by the legal entity in each applicable county or $25,000, if a legal entity misrepresents information on the change in ownership statement.

All Legal Entities. This bill would amend Section 64 to require the Franchise Tax Board to furnish the Board with the name and address of any entity that does not respond to the change in ownership question on partnership, bank, and corporate tax returns.

In General

The Board of Equalization's Legal Entity Ownership Program (LEOP) was formed to assist in the discovery of changes in control and ownership of legal entities pursuant to subdivisions (c) and (d) of Section 64 of the Revenue and Taxation Code.

- Under Section 64(c) whenever a person or legal entity acquires more than 50% of the ownership interest in another legal entity, the real property of the acquired entity is reassessed.
- Section 64(d) provides that if real property was excluded from a change in ownership under Section 62(a)(2) when transferred into a legal entity and subsequently more than 50% of those original co-owner's shares are transferred, the real property that was previously excluded will be reassessed.

The LEOP unit assists assessors in discovering changes in ownership or control that might not otherwise be captured by a county's own discovery systems. Discovery of these changes is required by law and can be difficult because ordinarily there is no recorded deed or notice of a transfer of an ownership interest in a legal entity.

LEOP Operations

- Receives a list from the Franchise Tax Board of legal entities that have reported a change in ownership on their income tax returns or have left the question blank.
- Monitors business publications, such as *Mergers & Acquisitions* and the Wall Street Journal.
- Sends a "Statement of Change in Control or Ownership of Legal Entities" to each entity.
- Analyzes completed statements to determine whether there has been a change in control or ownership.
- Notifies county assessors of changes in control and ownership.

Background

The 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 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.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the Pacific Institute for Community Organization (PICO) www.PICOcalifornia.org and the California Tax Reform Association www.caltaxreform.org. Its purpose is to cause more frequent reassessment of nonresidential property to bring assessed values of impacted properties to current market value levels.

2. **Key Amendments.** The **May 22** amendment, relating to the requirement that publicly traded companies annually report their real property holdings, specifies the date, December 31, as of which all real property holdings for the year would be reported for the following year. The amendment also provides that the penalty for failure to provide a complete statement would not be imposed as a result of a reasonable error or omission on the statement that is filed. The **May 14** amendment provided that any penalties levied on a legal entity for failure to a file change in ownership statement would be added to the assessment roll, as current law provides. (The April 21 amendment would have transferred any penalty monies from local governments to the Board.) The **May 6** amendment provided that when the Board receives real property statements from publicly traded companies, it would transmit any relevant information contained in the statement to the assessors of the counties in which the affected property is located. The **April 21** amendments added the requirement that publicly traded companies annually file real property statements with the Board and modified the requirements and penalties for legal entities to file a change in ownership statement with the Board after a legal entity change in control. See the prior analysis of the 12/02/02 version of the bill for a full discussion of change in ownership of property owned by legal entities.

3. **Changes in ownership or control 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 assessor could use to track transfers of ownership interest in a legal entity.

4. **This bill would require that publicly traded companies (except state assessees) provide the Board with a list of real property they own in California.** When the Board discovers a change in ownership of a legal entity from a source other than filing a change in ownership statement without any prompting by the Board, this information could be used to provide a county assessor with information about properties subject to reappraisal located in his or her county. Currently, the Board does not maintain an inventory of any legal entity's real property holdings in California. State assessees would not be required to file these statements as they are already required to report their real property holdings in other documents filed with the Board.

5. **Some legal entities do not respond to the Board's request for information about potential changes in ownership.** The penalties for failing to respond can

be automatically abated if the legal entity eventually responds. This bill deletes these automatic abatement provisions.

6. **In contrast to the income tax returns for income tax purposes, the requirement to file a change in ownership statement for property tax purposes is not widely known or understood.** Legal entities may not file statements, in part because the legal entity may not understand that for California property tax purposes, transfers of ownership interests in the legal entity have triggered a change in ownership. It is especially difficult for legal entities that have been granted a change in ownership exclusion under Section 62(a)(2). They fall into a special class that requires that cumulative transfers of interests be tracked after the excluded property transfer to determine when more than 50% of the total interests in the legal entity have been transferred. At that point, the company must report the change in ownership.

7. **The Franchise Tax Board currently informs the Board of legal entities that leave the property tax questions blank on their income tax returns**. This provision would codify existing adminstrative practices.

8. **The provisions requiring legal entities to file a change in ownership statement upon request should be restored.** As an aid in discovering changes 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, such as Mergers & Acquisitions and the Wall Street Journal. This bill inadvertently deletes the provision which requires these legal entities to respond to the Board's request to file a change in ownership statement. Thus, the Board would have no specific statutory authority to request that a statement be filed in response to these alternative methods of discovery and would have to depend on voluntary filings by the legal entities, who in some cases, may be unaware of the requirement to file a statement. A requirement to file a statement upon request and a penalty for failure to respond to the Board request for information should be retained.

9. **The provisions requiring publicly traded companies to report annually is currently limited to transfers of property.** In proposed Section 471, the annual list of changes is limited to "transfers." Assuming the term "transfers" is limited to property the legal entity no longer owns, it seems that new acquisitions of property during the prior calendar year should also be reported.

10. **This bill establishes a penalty for misrepresenting that a change in ownership has occurred**. In periods of declining real estate value, some property owners have inquired about methods to intentionally trigger a "change in ownership" to lock in a new lower base year value.

11. **Related legislation.** Senate Bill 3x contains intent language identical to the intent language in this bill. Assembly Constitutional Amendment 16 (Hancock) would

place a constitutional amendment before voters to require annual reassessment of nonresidential, nonagricultural property to current fair market value.

COST ESTIMATE

Pending. The Board would incur additional costs for processing, filing, and maintaining the new real property statements filed by publicly traded legal entities.

REVENUE ESTIMATE

This measure has no direct revenue impact. Increased penalties may be an incentive for legal entities to properly file a change in ownership statement when a change in ownership occurs.

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