220.0090

§ (2)(a)(2) not applicable

STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
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February 14, 1992

Re: Property Tax; Corporate Reorganization

Dear Mr. :

Please excuse our delay in responding to your letters of July 31 1991 and August 15, 1991 to Mr. Richard Ochsner. Other matters requiring our attention have made such delay unavoidable.

In your letters, you request our concurrence that there will be no change in ownership for property tax purposes as a result of the following assumed facts and proposed transactions:

ASSUMED FACTS

R is a California corporation. The stock of R is owned approximately as follows: 62.50% by B; 31.25% by G; and 6.25% by C (B, G, and C are individuals).

H is a California corporation. The stock of H is owned 74.6% by R; 24.8% by E (a California corporation wholly owned by individual J); and .6% by W (an individual). H is the owner of real property located within the State of California.

N is a newly-organized Nevada corporation. The stock of N will be owned approximately as follows: 55% by B; 28% by G; 10% by J; 6% by C; and 1% by W.

Z is a Nevada corporation, all of the stock of which is owned by W.

PLAN OF REORGANIZATION

1. W will transfer the stock of H to Z as a capital contribution.

2. Z will merge into R and W will receive stock of R.

3. E will merge into R and J will receive stock of R.

4. At this point in time, the stock of H will be owned 100% by R and the stock of R will be held in identical fashion to the stock of N.

5. H will be merged into R.

6. R will be merged into N.

LAW AND ANALYSIS

The transfers of stock of H by W to Z and by E and Z to R (by way of merger) would not constitute a change in ownership under Revenue and Taxation Code* Section 64(c) because no person or entity would obtain control of H as a result of such transfers. (R was already the controlling shareholder of H prior to the transfers.)

Also, since R always held at least 74.6% of the stock of H, the proposed transfers of H stock would not result in a change in ownership under Section 64(d).

At the time of the merger of H into R, R would own 100% of the outstanding stock of H. Thus, for purposes of Section 64(b) R and H would be affiliated corporations. The transfer of real property from H to R (by way of merger), therefore, would be excluded from change of ownership under Section 64(b), assuming Section 64(b) is applicable as discussed below. Upon merger of R into N, the transfer of the real property from R to N would be excluded from change in ownership under Section 62(a)(2) as a transfer between legal entities which results solely in a change in the method of holding title and under which the proportional ownership interests in the property remain exactly the same after the transfer. See also Property Tax Rule 462(D)(2)(B), and (m)(5).

In your letter of August 15, 1991, you also ask whether there would be any difference in property tax results if, prior to R merging into N, the stockholders of R contributed all of the outstanding stock of R to N as a capital contribution, so that R is a wholly-owned subsidiary of N immediately prior to the merger of R into N.

Section 64(c) provides that when a corporation obtains control in any corporation through the purchase or transfer of corporate stock, that purchase or transfer of such stock shall be a change in ownership

* All statutory references are to the Revenue and Taxation Code unless otherwise indicated.

of property owned by the corporation in which the controlling interest is obtained. We have taken the position, however, that transfers of stock such as you have proposed here (i.e., all of the R stock being transferred to N) are excluded from change in ownership under Section 62(a)(2) because the proportional ownership interests in the real property remain the same after the transfers. The ensuing merger of R into N would be excluded from change in ownership under Section 64(b), if applicable, as a transfer between affiliated corporations. (See discussion below as to the applicability of Section 64(b)).

As indicated above, each separate step in the reorganization is excluded from change in ownership when analyzed as a separate step.

With respect to the applicability of Section 64(b), that section sets out two situations where transactions among legal entities will not result in a change in ownership: (1) a corporate reorganization where all of the corporations involved are members of an affiliated group and the transaction qualifies as a reorganization under Section 368 of the Internal Revenue Code and is accepted as a nontaxable event by similar California statutes; and (2) any transfer of real property among members of an affiliated group.

The courts have concluded that with respect to the first situation, the phrase "members of an affiliated group" in Section 64(b) means affiliation from the beginning until the end of the transaction. Pueblos Del Rio South v. City of San Diego (1989) 209 Cal. App. 3d 893, 905; see also Sav-on Drugs, Inc. v. County of Orange (1987) 190 Cal. App. 3d 1611, 1626, 1621 in which the court concluded that in order to qualify under Section 64(b), the Legislature intended that the organizations involved must be an affiliated group before the reorganization takes place; and, becoming an affiliated group cannot be just one step in the reorganization.

The Court of Appeal in Sav-on and Pueblos was dealing with the issue of whether Section 64(b) or Section 64(c) was applicable in the context of a corporate reorganization. In each case the court concluded that Section 64(b) was inapplicable and that a change in ownership occurred under Section 64(c).

Although the facts of this case present the question of whether Section 64(b) or Section 61(i) (transfer of real property from corporation to corporate shareholder) is applicable in the context of a corporate reorganization, we think it is possible, if not likely that since R and H did not become affiliated until the third step of the plan of reorganization, a court could find Section 64(b) inapplicable for the same reasons here as in Sav-on and Pueblos.

Moreover, since there would have been a change in ownership had H been merged directly into R or into N without the intervening steps

having been taken (because of the inapplicability of Sections 62(a)(2 and 64(b), a question arises as to the applicability of the step transaction doctrine. See generally, Shuwa Investments Corporation v County of Los Angeles (1991) 91 Daily Journal D.A.R. 16069 which sets forth the tests to determine the applicability of the step transactio doctrine to a given set of circumstances. In our view, the local assessor is best suited to apply such tests in determining whether th step transaction is applicable in a given case.

The views expressed in this letter are advisory only and are not binding upon the assessor of any county. The ultimate decision rests with the determination of the local assessor.

Very truly yours,

Eric F. Eisenlauer

Eric F. Eisenlauer
Senior Tax Counsel

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cc: Mr. John W. Hagerty
Mr. Verne Walton