June 19, 1998

The Honorable Roger G.F. Fong
Sacramento County Assessor
Attn: Ms. Margaret Karr, Supervisor
700 H Street, Room 104
Sacramento, CA 95814

In Re: Change in Ownership - Interests of General and Limited Partners in Limited Partnerships - Section 62 (a)(2) Exclusion.

Dear Ms. Karr:

This is in response to your July 28, 1997 letter in which you requested our opinion concerning the change in ownership consequences of a transfer of real property to a limited partnership, in which the general partner has management and control of the partnership property. We regret this delay in responding which resulted from internal demands. The facts submitted are as follows:

1. The Enterprises, L.P., ("L.P.") is a California limited partnership formed in 1996 under the "Limited Partnership Agreement of Enterprises, L.P."
("Agreement") between:

   general partner and limited partner, , Trustee of the D Trust
   ("D.M. Trust"), and limited partners, , Trustee of the I Trust
   ("I.M. Trust"), Terry ("Terry"), and Pamela ("Pamela").

L.P. is organized for the purpose of acquiring, maintaining, improving, leasing and ultimately selling certain real property. (Agreement, Article 2.05, page 5.)

2. Per the Agreement, in "Exhibit A, Partner's Interests," the percentage partnership interests of each of the partners in the L.P. are as follows:
D.M. Trust - 1% as General Partner
D.M. Trust - 2% as Class A Limited Partner
D.M. Trust - 14.856% as Class B Limited Partner
I.M. Trust - 50% as Class B Limited Partner
Terry - 16.072% as Class B Limited Partner
Pamela - 16.072% as Class B Limited Partner

3. The partners' interests in the L.P. capital, per "Capital Contributions," described in Section 3.01, and "Capital Accounts," described in Section 4.01, are:

Section 3.01. "Each of the partners listed on Exhibit A shall contribute cash or property to the Partnership in exchange for an interest in the Partnership. The cash and the stated value of the property so contributed by each Partner shall be credited to such Partner's Capital Account pursuant to Section 4.01 hereof."

Section 4.01, Paragraph B, each partner's capital interest is equivalent to the amount of money and fair market value of property contributed by the Partner to the L.P., and may be increased by allocations to the partner of gain or income, and decreased by allocations to the partner of loss, distributions, or deductions, or otherwise adjusted in accordance with Treasury Regulations section 1.704-1(b)(2)(iv).

Section 4.01, Paragraph C, "the Capital Accounts of the Partners shall be adjusted to reflect the manner in which the unrealized income gain, loss and deduction inherent in such property (that has not been reflected in such Capital Accounts previously) would be allocated among the Partners, if there were a taxable disposition of such property for its fair market value on the date of Distribution."

4. The partners' interests in the L.P. profits, cash flow, net income and losses as provided in "Distributions and Allocations," including Sections 5.01 - 5.09, are:

Per Section 5.01, "Cash Available for Distribution shall be distributed among the partners in amounts and at such times as may be determined by the Managing Partner."

Under Section 5.02, the Class A Limited Partners (there is only one, DM Trust as General Partner), are entitled to cash in an amount equal to the "guaranteed payment" of $16,200 annually, constituting "guaranteed payments within the meaning of Code section 707(c) and shall not be treated as distributions for purposes of computing the recipients' Capital Accounts."
Per Section 5.03, as to the allocation of income and losses, based on a list of priorities, each receives "interests in the Net Income and Losses" pro rata according to their respective percentage interests during the year.

Per Section 5.04, paragraph A, "income, gain, loss and deduction with respect to property contributed to the capital of the Partnership by a Partner shall be allocated among the Partners to take into account the difference between the basis of the property to the contributing Partner and the amount credited to the contributing Partner's Capital account with respect to the contributed property..."

Your questions are 1) whether the general partner (D.M. Trust) of a limited partnership automatically owns 100% of the L.P. real property and the limited partners none (holding instead only personal property interests in their respective capital accounts), and 2) whether the deed transfer of the real property from the individuals and their trusts to the L.P. is excluded from change in ownership under Revenue and Taxation Code Section 62(a)(2).

For the reasons hereinafter explained, the answer to your first question is no, and the answer to your second question is yes, providing that further documentation is submitted. The Agreement provides both the general and limited partners with indirect ownership interests in the L.P. real property. The deed transfer of the real property from the individuals and their trusts to the L.P. may be excluded from change in ownership under Section 62(a)(2), provided the respective interests of each partner in the partnership capital and profits after the transfer were exactly proportional to their interests in the real property before the transfer.

LAW AND ANALYSIS

As you are aware, Revenue & Taxation Code Section 60 defines "change in ownership" as a "transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest." Within that definition is the provision of Section 61 (j) which includes as a change in ownership, "the transfer of any interest in real property between a corporation, partnership, or other legal entity and a shareholder, partner, or any other person." An applicable exclusion is Section 62(a)(2) which excludes from change in ownership, "any transfer between an individual or individuals and a legal entity or between legal entities, ... , which results solely in a change in the method of holding title to the real property and in which proportional ownership interests of the transferors and transferees, whether represented by stock, partnership interest, or otherwise, in each and every piece of real property transferred, remain the same after the transfer."1

1 With regard to partnerships specifically, Rule 462.180 (e)(1) states that "Except as provided in (b)(2) [analogous to Section 62(a)(2) above], when real property is contributed to a partnership or is acquired, by purchase or otherwise, by the partnership, there is a change in ownership of such real property, regardless of whether the title to the property is held in the name of the partnership or in the name of the partner(s), with or without reference to
In determining whether the Section 62(a)(2) exclusion is applicable to the transfer in the instant case, the respective partnership interests of each LP partner, both limited and general, must be identified.

**Question 1:** Does the general partner of a limited partnership automatically own 100% of the partnership real property and the limited partners none (holding instead only personal property interests in their respective capital accounts)?

**Answer:** No.

Your concern is that the nature of a limited partnership is such that the limited partners have only personal property interests in the partnership, and the general partner, by virtue of his management and control, owns 100% of the interests in the partnership real property. We do not share this view. The interpretation that a limited partner’s partnership interest represents only a personal property interest in the limited partner’s capital account could only be based upon an interpretation of several Corporations Code provisions without consideration of change in ownership of legal entities provisions. Under Revenue and Taxation Code Sections 60 - 64, and under Property Tax Rule 462.180, “Change in Ownership - Legal Entities,” which contain the statutory and regulatory scheme to be applied for property tax purposes, the ownership interests of partners (whether limited or general) in a partnership (whether limited or general) are represented by their percentage interests in the total partnership capital and profits as expressed in the partnership agreement. Consequently, the conclusion that a general partner in a limited partnership automatically owns 100% of the partnership real property is erroneous for property tax change in ownership purposes for the following reasons.

First, under the California Revised Limited Partnership Act, Corp. Code §15611 et seq., a “limited partnership” means “a partnership formed by two or more persons under the laws of this state and having one or more general partners and one or more limited partners.” (Corporations Code §15611 subd. (r).) It is formed at the time of the filing of the certificate of limited partnership in the office of the Secretary of State in conjunction with entering into a partnership agreement. (Corp. C§15621, subd. (b).) The interests of all partners in a limited partnership are defined as “the aggregate interests of all partners in the current profits derived from business operations of the partnership.” (Corp. C. §15611, subd. (o).) The interests of the limited partners are defined as “the aggregate interests of all limited partners in their respective capacities as limited partners in the current profits derived from business operations of the partnership.” (Corp. C. §15611, subd. (p).) As to the interests of all partners in the partnership real property, Corp. Code Sec. 15671 states that “An interest in a limited partnership is personal property and a partner has no interest in the specific partnership property.” The term “personal property” in the context of this section and as applied to property tax, distinguishes a partner’s direct interest in the limited partnership from his/her indirect interest in the partnership property. Thus, no partner, general or limited, may claim, possess, assign, or convey the partnership real property to the

the partnership. Except as provided in (b)(2), the transfer of any interest in real property by a partnership to a partner or any other person or entity constitutes a change in ownership.
exclusion of the other partners, since it is owned directly by the limited partnership as an entity and only indirectly by the individual partners. 2

Secondly, in defining “ownership” in a limited partnership for property tax purposes, Section 64 and Rule 462.180(d)(1)(B) provide that an “ownership interest” in a partnership or limited partnership constitutes “the total interests in both partnership capital and profits,” and the partner’s classification as a “limited” or a “general” partner is disregarded. 3 Thus, a general partner of a limited partnership may make contributions to the capital (cash or property), of the limited partnership and share in the profits and losses of, and in distributions from, the limited partnership as a general partner. (Corp. Code §15644). Further, a person may be a general partner and a limited partner in the limited partnership at the same time. Limited partners may also acquire specific shares or interests in the profits and losses, or in the partnership capital in return for his/her contribution, and may allocate among themselves, as well as prioritize, the distribution of profits, return of capital, or any other matter. (Corp. Code §15653.) Distributions of capital and profits from the limited partnership to the general and limited partners must follow the terms of the limited partnership agreement, and if the terms do not otherwise provide, distributions which are a return of capital shall be made in proportion to the contributions of each partner. Distributions which are not a return of capital shall be made in proportion to the allocation of profits. (Corp. Code §15654.)

Thirdly, a valid limited partnership can be formed notwithstanding the fact that either the general or the limited partner(s) may have no interests in the capital or profits. Since the character and percentage of the partners’ capital and profits interests are based on the terms of the partnership agreement, the language of a particular agreement may indicate that certain partners have no partnership interests. Thus, we have taken the position that if the terms of the limited partnership agreement provide that some of the limited partners are to have no right to share in either the partnership capital or profits accounts, then no partnership interests can be attributed to them for purposes of determining the change in ownership consequences. (See Annotation No. 220.0387, McManigal Letter, October 21, 1988, attached.) In these situations, only the actual general and limited partners who have definite rights to the capital and profits own 100% of the partnership interests (which represent the ownership of the real property and other assets held by the limited partnership). Similarly, the fact that the general partner in a limited partnership may be paid a salary (e.g., cash distribution, guaranteed payment) for his/her management services (and has all of the rights and powers of management, Corp. Code §15643), does not mean that he has an interest in the partnership capital and profits. As discussed in answer to question 2 below, a “guaranteed payment” under Internal Revenue Code section 707(c) is generally treated as a salary.

2 Once property is acquired by a partnership, the nature of the interests held in the partnership are defined by the partnership agreement. Where the specific terms of the agreement express the interests of the partners in the capital and profits, (both real property and cash or other assets), those terms are controlling.

3 While there are no definitions of “capital” or “profits” in the property tax rules or the statutes, a “capital” interest in a partnership is described for income tax purposes, as any interest in the assets (partnership property, cash, assets) to which any partner is entitled upon his withdrawal from the partnership, or upon the liquidation of the partnership. This “capital interest” is distinguished from the right to participate in the earnings, profits, and losses of the partnership. (Treasury Regulation Sec. 1.704-1(e.).)
Honorable Roger G. F. Fong

June 19, 1998

and not as a distribution from the partnership capital or profits. As such, the salary is not considered in the computation of the partners' percentage interests in the partnership for change in ownership purposes.

Finally, where taxpayers are asserting the existence of a valid limited partnership (or any legal entity), the assessor is entitled to treat such limited partnership (or entity) as valid, and the partners' express intentions with regard to their capital and profits interests as controlling, based upon the terms of the partnership agreement. (See Maletis v. United States (1952) 200 F.2d 97, 98, wherein the court held that the burden is on the taxpayer to establish that the form of business he has created for tax purposes, and has asserted in his tax returns is valid with the interests specified therein, is in fact not a sham or unreal, and if it is in fact unreal, the government and not the taxpayer should have the sole power to sustain or disregard the effect of the fiction in order to check opportunities for manipulation of taxes.) In the instant case therefore, the Agreement sets forth the particular interests held by each of the partners (limited and general) in the partnership capital and profits, as discussed below.

**Question 2. Should the deed transfer of real property from the individuals (and trusts) to L.P. be excluded from change in ownership under Section 62(a)(2)?**

**Answer: Yes, providing further documentation is submitted.**

For purposes of applying Section 62(a)(2) to the transfer of real property to any partnership or legal entity, it is necessary to look through the partnership to determine the actual percentage interests of the partners in the partnership capital and profits following the transfer. Here, the contribution of an individual’s or trust’s interest in property to the L.P. in exchange for the same percentage interest in the L.P. capital account, constitutes a proportional interest transfer as to L.P. capital. That is, each partner’s capital interest is the percentage of the value in the L.P.’s assets which represents his/her percentage of interests in the real property and that would also be distributable to such partner upon his withdrawal from or liquidation of L.P. This appears to be expressly stated in the language of Section 3.01 of the Agreement:

"Each of the Partners listed on Exhibit A shall contribute cash or property to the Partnership in exchange for an interest in the Partnership. The cash and the stated value of the property so contributed by each Partner shall be credited to such Partner’s Capital Account pursuant to Section 4.01 hereof."

Similarly, the contribution of an individual’s interest in property to the L.P. in exchange for the same percentage interest in the L.P. distributions and allocations (profits account) constitutes a proportional interest transfer as to the L.P. profits. That is, each partner’s profits interest is the percentage of the total profits earned and attributed to such partner from the date of the commencement of the L.P. (the date of filing of the Certificate of Limited Partnership, per Section 2.06) and the date of that partner’s withdrawal from or the dissolution of the L.P. (See Sections 5.01 - 5.09, “Distributions and Allocations”.) It should be noted that in these particular provisions, there is an annual “guaranteed payment” (within the meaning of Internal Revenue Code section 707(c)) of $16,200, to the Class A Limited Partner (Trustee for DM Trust), per
Section 5.02 of the Agreement. A "guaranteed payment" under IRC 707(c) is a payment which: 1) is determined without regard to the income of the partnership; 2) is made to a partner for certain services; 3) is considered as made to one who is not a partner; and 4) is treated as a trade or business expense under IRC section 162(a). As such, a guaranteed payment is generally not treated as a distribution from the partnership capital or profits and thus, has no effect on the computation of the partners' percentage interests in the partnership capital or profits for change in ownership purposes. This seems to be the situation here, since Section 5.02 expressly states that guaranteed payments under IRC section 707(c) shall not be treated as distributions for purposes of computing the capital accounts. Obviously, if the payment provision had the effect of altering any partner's interest in the capital or profits, the proportionality required under Section 62(a)(2) would not exist.

Based on the Agreement, it appears that the exclusion in Section 62(a)(2) would apply, since percentage interests in the LP capital and profits were transferred to each partner in direct proportion to their respective contributions of real property interests to the L.P. The factual question which remains unanswered however, is what were the respective ownership interests of each partner in the real property before the transfer occurred. The 1996 Grant Deed recorded by the partners, indicates that each of them, i.e., Dale as Trustee of D.M. Trust, and Dale as Trustee of I.M. Trust, Terry, and Pamela, were co-owners in the property at the time of the transfer. Unfortunately, there is no other documentation to establish the exact fractional or percentage interests they each owned. Furthermore, since the two Trusts apparently owned percentages of the property, the trust instruments should be reviewed to identify the beneficiaries of the Trusts, the beneficiaries' interests under the Trusts, and whether or not the Trusts are revocable by the trustor. Finally, a change in ownership statement as required by Section 480 and a Preliminary Change in Ownership Report under Section 480.4 should have been filed at the time of the transfer, with at least the percentage interest information provided, in order for the L.P. to verify its qualification for the exclusion under Section 62(a)(2). Therefore, before a final determination can be made regarding the applicability of the exclusion, the information discussed as well as the change in ownership statement and PCOR must be submitted by the L.P.

If, after examining the information submitted by L.P. that the Section 62 (a)(2) exclusion is applicable to exclude the 1996 deed transfer from change in ownership and reappraisal, then each L.P. partner, whether limited or general, would be an "original coowner" under Revenue and Taxation Code section 64 (d) for purposes of future transfers of interests in the limited partnership.

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4 Sections 61(h) and 62(d) treat the beneficiary of a trust as the owner of the trust property, unless the trust is revocable by the trustor, in which case the trustor remains the owner until the trust becomes irrevocable.

5 The statutory provisions of Section 62(a)(2) have been interpreted by Property Tax Rule 462.180 (b)(2), which identifies and defines "original co-owners." The rule states in pertinent part: "[Excluded from the change in ownership provisions are] transfers of real property between separate legal entities or by an individual(s) to a legal entity (or vice versa), which result solely in a change in the method of holding title and in which the proportional ownership interests in the property remain the same after the transfer. (The holders of the ownership interests in
The views expressed in this letter are, of course, only advisory in nature. They represent the analysis of the legal staff of the Board based on the present law and the facts set forth herein. Therefore, they are not binding on your office or on any person or entity.

Sincerely,

Kristine Cazadd
Senior Tax Counsel

LAA:ba
Attachment: Annotation No. 220.0387, C/10/21/88

cc:  Mr. Larry Augusta
     Mr. Richard Johnson
     Ms. Jennifer Willis

the transferee legal entity, whether such interests are represented by stock, partnership shares, or other types of ownership interests, shall be defined as "original co-owners" for purposes of determining whether a change in ownership has occurred upon the subsequent transfer(s) of the ownership interests in the legal entity.)"
STATE BOARD OF EQUALIZATION
1020 N STREET, SACRAMENTO, CALIFORNIA
P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001

916/323-7715

October 21, 1988

Dear,

This is in response to your September 26, 1988, letter to Mr. where you enclosed copies of information received concerning the Family Funeral Home, a California Limited Partnership's 1986 transfer of real property to and husband and wife as community property, and you asked whether the transfer constituted a change in ownership for property tax reassessment purposes.

According to the the Limited Partnership was formed for the sole purpose of purchasing the business and the real property and was a substitute for a mortgage, in other words, a financing transaction. In support thereof, they claimed that they were the general partners and also limited partners; that all the other limited partners were limited partners either because they advanced funds/loans to or performed services for the Limited Partnership; that such limited partners were entitled to receive only the amounts loaned or agreed upon in return for the services performed, as the case might be, plus interest at agreed-upon rates; that such limited partners received only such amounts plus interest thereupon; and that upon the discharge of the loans and such limited partners withdrawal from it, the Limited Partnership transferred the property to them. Thus, they referenced Revenue and Taxation Code section 62(c)(1), which excludes from change in ownership the termination or reconveyance of a security interest, as the basis upon which the transfer should not constitute a change in ownership.
Subsequent to the September 26 letter, Mr. ... received a copy of the Limited Partnership Agreement. During the course of our October 19, 1988, telephone conversation, he confirmed that under the Agreement, the limited partners, excepting the ... were entitled to receive only the amounts loaned or agreed upon in return for the services performed plus interest. Thus, they had no interest in the profits or losses of the Limited Partnership.

Under the California Revised Limited Partnership Act, set forth in Title 2, Chapter 3, of the Corporations Code, sections 15611 through 15723, a limited partnership is a partnership formed by two or more persons under the laws of California and having one or more general partners and one or more limited partners (§ 15611(j)). Persons desiring to form such a partnership execute, acknowledge and file a certificate of limited partnership (§ 15621), share in the partnership profits (§ 15653), and, upon dissolution, may share in partnership assets/property (§ 15684). Given these characteristics of limited partnerships and the apparent structuring of this limited partnership to grant interests in profits and losses only to the ... and to limit the interests of the other limited partners to the amounts loaned or agreed upon in return for the services performed plus interest, such suggests that the Limited Partnership was, to the extent that it involved those other than the ... intended to be used as a financing vehicle. In our view, however, such is not determinative in this instance since it is the transfer from the Limited Partnership to the ... which is in question.

In this regard, the Limited Partnership did exist as an entity, separate and apart from the ... as its general and limited partners, and critical is whether the individual interests in the Limited Partnership at the time of the transfer to the ... as husband and wife was the same before and after the transfer such that Revenue and Taxation Code section 62(a)(2) could apply:

"Change in ownership shall not include:

(a)(1) ....

(2) Any transfer between ... individuals and a legal entity ... which results solely in a change in the method of holding title to the real property and in which proportional ownership interests of the transferors and transferees, whether represented by ... partnership interest, or otherwise, in each and every piece of real property transferred, remain the same after the transfer...."
In taking the property as husband and wife as community property, the took the property equally (50 percent and 50 percent). Thus, for section 62(a)(2) to be applicable, the respective interests in the Limited Partnership must have been equal at the time of the transfer (50 percent and 50 percent), a factual matter to be ascertained by you since we do not have that information.

In conclusion, Revenue and Taxation Code section 64(c) does state that when a person obtains a majority interest in a partnership through the purchase or transfer of a partnership interest, such purchase or transfer shall be a change in ownership of property owned by the partnership in which the controlling interest is obtained. As indicated in our July 15, 1983, letter to County Assessors Only, No. CAO 83/17, Ownership Interest in Entities Held by Spouses as Joint Tenants, copy enclosed, it has been our position that a husband and wife holding ownership interests in legal entities as joint tenants are to be considered separate individuals, each owning 50 percent of the ownership interests in question. The marriage relationship cannot, in our view, be used to attribute the ownership of one spouse to that of the other so as to find that one spouse has directly and indirectly acquired more than a 50 percent interest in a legal entity. Thus, if the had among themselves equal ownership interests in the Limited Partnership at its inception, and if their interests remained constant throughout, including that point in time at which the other limited partners had retired from the Limited Partnership and the Limited Partnership had transferred the real property to the the would have each owned no more than a 50 percent interest in the Limited Partnership at any time. Under such circumstances, section 64(c) would not be applicable, there having been no acquisition at any time of more that a 50 percent interest in the Limited Partnership by either Mr. or by Mrs.

Very truly yours,

James K. McManigal, Jr.
Tax Counsel

JKM/rz

Enclosures