State of California

Board of Equalization

Memorandum

To :

Date : February 18, 1986

From : Richard H. Ochsner RHO [illegible]

Subject : Shopping Mall,

By memo, dated February 3, 1986, [illegible] has relayed your request for a memorandum which explains the law applicable to the 1979 reappraisal of this property and analyzes the taxpayer's argument that the result is based upon form rather than substance.

The facts of this matter are set forth in a letter dated January 10, 1986, from Mr. [illegible], Executive Vice President, The [illegible] Company, [illegible], to the Board's appraiser Mr. [illegible]. A copy of the letter is attached.

Briefly, the [illegible] Mall was acquired in 1971 by the [illegible] Center, a limited partnership (hereafter Partnership "A"). In January of 1979, the mall was transferred by Grant Deed from Partnership A to [illegible] Center Joint Venture, a California general partnership (hereafter Partnership "B"). Partnership B was owned 50 percent by Partnership A and 50 percent by [illegible] Corporation (hereafter "Corporation"). The nature of the 50 percent ownership interests of the partners is not explained. We assume that each partner had a 50 percent interest in profits and a 50 percent interest in the capital of the partnership. The [illegible] County Assessor treated the 1979 transaction as a change in ownership of the [illegible] Mall and reappraised the entire property.

Although there were subsequent transfers, Mr. O[illegible] only objects to the treatment of the 1979 transaction. Our discussion will, therefore, be limited to this transaction. As we understand it, he argues that only 50 percent of the [illegible] Mall should have been reappraised because, in substance, the transaction was merely a transfer of a 50 percent interest in the property to the Corporation and that, in substance, the other 50 percent of the property was retained by Partnership A and did not undergo a change in ownership.

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The question presented is whether the January 1979 transfer of the Mall from Partnership A to Partnership B constituted a change in ownership of the entire property. Revenue and 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. The facts presented here indicate that the transfer of the Mall by Grant Deed from Partnership A to Partnership B satisfies this basic definition. Partnership B received a present interest in the mall which included the beneficial use therof. The value of the interest was substantially equal to the value of the fee interest in the mall. Thus, all of the conditions of the definition appear to be satisfied. In addition, Revenue and Taxation Code Section 61 lists a series of specific types of transactions which are included within the definition of change in ownership. Subdivision (i) provides that the transfer of an interest in real property between a corporation, partnership, or other legal entity and a shareholder, partner or any other person is a change in ownership. These statutory provisions are interpreted by subdivision (j)(1) of property tax Rule 462, which provides that the transfer of any interest in real property to a corporation, partnership or other legal entity is a change in ownership of such real property transferred. Further, paragraph (5) of subdivision (j), dealing specifically with partnerships, provides in part that 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. There are, of course, exceptions to the foregoing rules. The primary exception found in Revenue and Taxation Code Section 62, subdivision (a)(2) and Rule 462, subdivision (j)(2)(B) relates to transfers of real property between separate entities 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. This exception is not applicable since the proportional interests of Partnership A did not remain the same after the transfer. Further, none of the other exceptions are applicable. Thus, it appears that under the statutes defining "change in ownership" and the applicable property tax rules, the assessor correctly determined that there was a change in ownership of the mall and that it was subject to reappraisal. Since the Grant Deed transferred 100 percent of the mall from Partnership A to Partnership B, we are not aware of any basis in the statute or regulations for concluding that anything less than 100 percent of the property changed ownership.

This conclusion is supported by the report of the Assembly Revenue and Taxation Committee entitled "Implementation of Proposition 13, Volume 1, Property Tax Assessment, Dated October 29, 1979." Attached are relevant portions of that report dealing with the theories which undergird the statutory rules dealing with change of ownership relative to legal entities. A reading of the relevant portions of this report indicates that while, as a general rule, transfers of ownership interests in legal entities, such as partnership interests, are not changes in ownership, transfers of real property between different legal entities do constitute changes in ownership. Specifically referencing partnerships, the report states that real property which is contributed to a partnership or which is acquired by the partnership 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 one or more indivisual partners. The report explains that this approach is based on the separate entity theory in which the general laws of the state endowing corporations, partnerships, joint ventures, associations, etc., with an identity separate from its owners is respected. Under this entity theory, Partnership A and Partnership B are treated as two separate and distinct legal persons. The transfer from Partnership A to Partnership B is treated the same as a transfer from individual A to individual B. As noted in the report, this separate entity theory is considered to be an important element of the statutory change in ownership scheme adopted by the Legislature. Based on the cited provisions of the report, it appears that the Assessor's treatment of the 1979 transfer of the Mall was wholly consistent with the intention of the Legislature as expressed in the committee's report.

In addition to concluding that the Assessor has properly applied the law, we also believe that the substance of the transaction supports this treatment. Mr. 's objection is based upon the argument that Partnership A, in substance, merely transferred a 50 percent interest in Mall to the Corporation. Had that actually happened, of course, only the 50 percent interest transferred would have been reappraised. In this case, however, there was a transfer of the entire property, not just a 50 percent interest, to a separate legal entity. This placed Partnership A in a very different position with respect to the 50 percent interest which Mr. contends Partnership A retained. Had Partnership A merely transferred a 50 percent interest to the Corporation and retained a 50 percent interest, it would have exercised complete dominion and control over that interest. It would, for example, have complete discretion in the manner in which

it used that property interest and in the manner of a sale of that interest. As a 50 percent partner in Partnership B, however, Partnership A was in a very different position. It was entitled to use the property only for partnership purposes. Further, only Partnership B could sell the property. The difference between the two situations is more than one of mere form. It is clearly a matter of substance arising from the legal distinctions attributed to separate entities. These are distinctions which have substance and have been recognized by the Legislature for tax purposes. For this reason, we cannot conclude that equity requires that only 50 percent of the property be reappraised on the transfer.

It can be argued, of course, that Partnership A could have transferred a 50 percent interest in the property to the Corporation and that only 50 percent of the property would have been reappraised. The argument goes that since the transaction could have been handled in that way it should be taxed in that fashion. It is a general principle of tax law, however, that a taxpayer having a choice of methods is bound by the tax consequences of his choice, even though some other method might have resulted in lower taxes. See Freeman v. Commissioner (1962) 303 Fed.2d 580; Zalk Joseph Co. v. Commissioner 10 T.C. Memo 662. Here, Partnership A had a choice of methods of transferring the property. It chose to transfer the entire property to Partnership B. Presumably this decision was based upon business or tax considerations which were sufficiently compelling to cause Partnership A and the Corporation to form the Joint Venture partnership. Since the parties voluntarily chose this method of operation, the law requires that they accept the tax consequences of that decision.

I trust that the foregoing satisfactorily answers your questions in this matter. Please let me know if I can be of further assistance.

RHO:cb

Attachments

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