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October 23, 1992

BURTON W. OLIVER
Executive Director

Dear Ms.

This is in response to your letter of June 10, 1992, requesting our views regarding certain transfers involving a California Limited Partnership. As I explained to you, I discussed the subject of this letter with Deputy Santa Barbara County Counsel, Kevin Ready on June 30, 1992. My notes indicated that he stated he would discuss the question with your office and get back to me if needed. I received no further word on this subject until your recent telephone call indicating that you desired a written response to your letter.

The information provided indicates that there were two transfers of certain real property. The first was recorded on December 27, 1990 and involved a transfer of real property from to a partnership. At that time the partnership was composed of and her two sons, and was listed as the general partner while and were all listed as limited partners.

In November 1991 the partnership transferred the property back to . At that time the partnership consisted of her two sons and , and her daughter

Parent/child exclusion claims have been filed for both transfers. As I understand it, your office has denied these claims because the transfers involved the partnership and were not directly between the parent and her children. You request the views of this office on whether the subject transfers qualify for the parent/child exclusion.

Revenue and Taxation Code section 60 (all section references are to the Revenue and Taxation Code) defines the term "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. Consistent with that definition, subdivision (i) of section 61 specifically provides that change in ownership includes the transfer of any interest in real property between a partnership and a partner. Thus, both the transfer from _____ to the partnership and the later transfer from the partnership to _____ constitute changes in ownership under the basic change in ownership provisions of the Revenue and Taxation Code. The sole question, then, is whether the subject transfers are excludable under terms of section 63.1, which provides an exclusion from change in ownership for certain parent/child transfers. For the reasons set forth below, I conclude that the subject transfers do not qualify for this exclusion.

Section 63.1 implements Proposition 58, which added subdivision (h) to section 2 of Article XIII A of the California Constitution. Subdivision (h) provides, in part, that the terms "purchased" and "change of ownership" shall not include the purchase or transfer of the first \$1 million of the full cash value of all other real property between parents and their children, as defined by the Legislature. Consistent with this provision, section 63.1, subdivision (a)(2), excludes from change in ownership the purchase or transfer of the first \$1 million of full cash value of all other real property "of an eligible transferor" in the case of a purchase or transfer between parents and their children. In carrying out its constitutional duty to define the terms of this exclusion, subdivision (c)(1) of section 63.1 provides that the term "purchase or transfer between parents and their children" means either a transfer from a parent or parents to a child or children of the parent or parents or a transfer from a child or children to a parent or parents of the child or children. Subdivision (c)(2) defines the term "children" as including natural children, step-children, a son-in-law or daughter-in-law or certain adoptive children. Subdivisions (c)(4) and (5) define the terms "eligible transferor" and "eligible transferee" as a parent or child of an eligible transferee or transferor, respectively. Subdivision (c) defines the term "transfer" as including any transfer of the beneficial ownership of property from an eligible transferor to an eligible transferee through the medium of an inter vivos or testamentary trust.

A reading of the terms of section 63.1 demonstrates that the language of the exclusion applies to transfers between

individuals who stand in the relationship of parent and child. Nothing used in the language of these provisions suggests that the Legislature intended to extend the exclusion to transfers between an individual and a legal entity such as a corporation or partnership. An examination of related change in ownership provisions such as section 61(i) dealing with transfers between a legal entity and an individual, and section 64, dealing with transfers of ownership interests in legal entities, demonstrates that the Legislature is capable of expressing its intention in clear terms where transfers involving legal entities are concerned. Thus, had the Legislature intended that the provisions of the exclusion were to apply to transfers between individuals and legal entities it would have clearly so provided.

This office participated with the Legislature in developing the terms of section 63.1 and we have consistently interpreted the provisions of section 63.1 as applying only to transfers between individuals. This is based upon the fact that the code section refers only to parents, children, eligible transferor, or eligible transferee. The latter two terms are defined in terms of parent or child. Further, the term "children" is defined with further specificity. None of these provisions suggest an intention to include a legal entity. Thus, it seems clear that the subject transfers do not qualify for exclusion under the provisions of section 63.1.

An argument has been raised that the legislative intent language found in Section 2 of Chapter 48 of the Statutes of 1987, which enacted section 63.1, supports the argument that the subject transfers qualify for exclusion. A careful reading of that language indicates just the contrary, however. When the provisions of section 63.1 were being developed it was recognized that the concept of transfers between parents and children was potentially quite broad and could include both transfers from a corporation or partnership wholly owned by a parent and transfers to a corporation or partnership wholly owned by a child. A deliberate decision was made, however, to limit the exclusions to transfers between individuals who were either a parent or a child. It was recognized that this limitation would mean that if a parent held property in a wholly owned corporation, he or she would have to transfer that property from the corporation to themselves and then transfer the property to the child in order to qualify for the exclusion. This extra step could have been challenged under the step transaction doctrine, however, on the grounds that it was unnecessary and the true substance of the transaction was a transfer from the corporation to the child which did not qualify for exclusion. The sole purpose of the intent language is to prevent the application of the step

transaction doctrine in this circumstance. Obviously, there would have been no need to include the intent language if the Legislature had intended that transfers from the parent's corporation to the child, or from the parent to the child's corporation, were excludable under the terms of the section. The very existence of the intent language demonstrates that the Legislature did not intend to extend the exclusion to the type of transfer presented here. While the intent language states that section 63.1 is to be "liberally construed" that statement is made in the context of the step transaction problem described above which only arises if transfers qualifying for the exclusion are limited to transfers between individuals.

Another argument has been raised based upon the definition of "transfer" found in subdivision (c)(7) of section 63.1 which refers to the transfer of the present beneficial ownership of property from an eligible transferor to an eligible transferee through the medium of an inter vivos or testamentary trust. As I understand it, it is argued that since this subdivision recognizes transfers of beneficial ownership through the medium of a trust this means that the beneficial ownership interest of a shareholder or partner in property owned by a corporation or partnership must also be recognized for purposes of this exclusion. That interpretation is clearly not consistent with change in ownership law, however.

Traditionally, the change in ownership rules applicable to property held in trust have followed the beneficial ownership of the property for change in ownership purposes. This is illustrated by subdivision (d) of Revenue and Taxation Code section 62 which excludes from change in ownership the transfer by a trustor of property into trust so long as the transferor is the present beneficiary of that trust or the trust is revocable. Thus, where the transferor continues to retain the beneficial ownership of the property either as the beneficiary of the trust or because the power to revoke the trust is retained, the statute has recognized that the transfer does not constitute a change in ownership.

The traditional treatment of corporations, partnerships and other legal entities has been quite different, however. As previously noted, subdivision (i) of section 61 provides that a change in ownership includes the transfer of "any interest in real property" between a corporation, partnership or other legal entity and a share holder, partner or any other person. By the same token, Revenue and Taxation Code section 64, subdivision (a), generally provides that the transfer of ownership interests in legal entities, such as corporate stock or partnership

interests, do not constitute a transfer of the real property of the legal entity. If the Legislature had intended to look through the corporation or partnership to the ultimate beneficial ownership of individual shareholders or partners, then it would have provided for a proportionate change in ownership of the real property owned by a legal entity whenever some of the ownership interests in that legal entity were transferred. That is, a ten percent transfer of the stock of a corporation from A to B would constitute a ten percent change in ownership of the corporation's property. It is clear that the Legislature did not adopt this approach. Rather, the transfer of ownership interests in a legal entity do not constitute a change in ownership of any portion of its real property unless a single corporation, partnership or other person obtains a controlling ownership interest. (See section 64(c)). In that case, there is a 100 percent change in ownership even though only a 51 percent ownership interest may have transferred. Further where a controlling interest in a legal entity has been acquired by another legal entity, the California courts have refused to look through the acquiring entity to the ownership interests of the stockholders. See Kraft, Inc. v. County of Orange (1990) 219 Cal.App.3d 1104; Twentieth Century Fox Film Corp. v. County of Los Angeles (1990) 223 Cal.App.3d 1158. In view of the distinctly different approach applied to property transferred through the medium of a trust versus property transferred to a corporation or partnership, it seems clear that the language of the definition of "transfer" found in subdivision (c)(7) of section 63.1 does not provide a basis for determining that the transfers at issue here qualify for the exclusion.

Our intention is to provide timely, courteous, and helpful responses to inquiries such as yours. Suggestions that help us to accomplish this goal are appreciated.

Very truly yours,



Richard H. Ochsner
Assistant Chief Counsel

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