California State

Board of Equalization

Legislative Enrolled Bill Analysis

Legislative, Research & Statistics Division

Assembly Bill 872 (Aguiar-Curry)
Program: Property Taxes
Sponsor: Author
Revenue and Taxation Code Section 62
Effective: Upon Chaptering

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Summary: This bill proposes a change in ownership parent-to-child exclusion for any transfer of stock in a qualified corporation that owns qualified real property, provided that the transfer is due to the death of the parent.

Fiscal Impact Summary: Given the narrow scope of this bill, the revenue impact is estimated to be minimal.

Existing Law: For property tax purposes, real property is reassessed from its Proposition 13 protected value (called the "base year value") to its current market value when real property undergoes a change in ownership.[1] When a "change in ownership" occurs, the law requires the assessor to reassess the property to its current fair market value.[2] Different laws apply to a person who buys real estate and a person who obtains ownership interests in a legal entity that owns real estate.

Interests in Real Property. Revenue and Taxation Code (RTC) section 61(j) 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 shareholder, partner or any other person. As a general rule, the law requires a reassessment equal to the percentage interest transferred. RTC section 62 provides numerous exclusions from change in ownership for a variety of real property ownership interest transfers. The following exclusions are relevant to this bill:

- **Proportional Ownership Interests Exclusion.** Relevant to legal entities, under RTC section 62(a)(2) and Property Tax Rule 462.180(b)(2), a transfer of real property to a legal entity does not result in a reassessment if the transfer is merely a change in the method of holding title and the proportional ownership interests in the real property are identical before and after the transfer. However, after a transfer of real property qualifies for this exclusion from reassessment, the persons holding ownership interests in the legal entity immediately after the transfer are considered *original co-owners* for purposes of tracking subsequent transfers of those interests.
- **Parent-Child and Grandparent-to-Grandchild Exclusion.** RTC section 63.1 provides that the terms "purchased" and "change in ownership" shall not include the purchase or transfer of the principal residence or the first $1 million of the adjusted base year value of all other real property between parents and their children and, under limited circumstances, from grandparents to their grandchildren. This exclusion applies to a transfer of real property and generally does not apply to a transfer of interests in a legal entity.

Interests in Legal Entities. RTC section 64 sets forth the change in ownership provisions for the purchase or transfer of ownership interests in legal entities (e.g., stock in a corporation, interests in a limited liability company, or interests in a partnership) that own real property. As a general rule, under RTC section 64(a),

[1] California Constitution, article XIII A, section 2; RTC section 110.1.
[2] Article XIII A, section 2; RTC sections 60 – 69.5.

transfers of ownership interests in legal entities do *not* constitute a change in ownership (and, therefore, no reassessment) of the legal entity's real property. However, there are two exceptions:

- **Change in Legal Entity Control.** RTC section 64(c)(1) requires reassessment when any person or entity obtains control through direct or indirect ownership or control, of more than 50 percent of corporation voting stock, or obtains more than a 50 percent ownership interest in any other type of legal entity. The reassessment applies to all California real property owned by the acquired legal entity (and any entity under its control).
- **Cumulative Transfers by "Original Co-Owners**." RTC section 64(d) requires reassessment when voting stock or other ownership interests representing cumulatively more than 50 percent of the total interests in a legal entity are transferred by any of the "original co-owners" in one or more transactions. The reassessment applies to California real property previously excluded from change in ownership under RTC section 62(a)(2).

Self-Reporting Requirement. Existing law requires legal entities to file a change in ownership statement[3] with the State Board of Equalization (BOE) within 90 days of a change in control or change in ownership under RTC section 64(c) or (d). The BOE notifies county assessors of changes in control and ownership of legal entities.

Proposed Law: This bill proposes a retrospective change in ownership parent-to-child exclusion for any transfer of stock in a qualified corporation that owns qualified real property, as long as the transfer is due to the death of a parent.

Qualified Corporation. This bill provides that a "qualified corporation" is a corporation that meets all of the following conditions:

- Created between March 1, 1975 and November 6, 1986, inclusive.
- The corporation owns qualified property.
- The only stockholders of the corporation are parents and their children.

Qualified Property. This bill provides that, for purposes of this exclusion, "qualified property" is a parcel of land that satisfies both of the following requirements:

- Contains the principal place of residence of the parents prior to their death that has been the continuous place of residence of a child of those parents since the creation of the qualified corporation.
- Its adjusted base year value as of the date immediately prior to the date of death of the last surviving parent does not exceed $1 million.

Report to BOE. This bill requires the county assessor to report quarterly to the BOE all transfers for which a claim for exclusion is made pursuant to these provisions and the amount of each exclusion claimed.

In General: California's system of property taxation values property at its 1975 fair market value, with annual increases limited to the inflation rate, as measured by the California Consumer Price Index, or 2 percent, whichever is less, until the property changes ownership or is newly constructed. At the time of

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[3] Form BOE-100-B, *Statement of Change in Control and Ownership of Legal Entities.*

the ownership change or completion of new construction, the value of the property for property tax purposes is reassessed based on current market value (called the "base year value"). Thereafter, the base year value is subject to annual increases for inflation. This value is referred to as the "factored base year value." This system results in substantial property tax savings for long term property owners.

Proposition 13. Proposition 13 was an initiative approved by voters on June 6, 1978, adding article XIII A to the California Constitution, and established a new system of property taxation as previously described. Related to this bill, subdivision (a) of section 2 of the initiative provided:

> The full cash value means the County Assessors valuation of real property as shown on the 1975-76 tax bill under "full cash value", or thereafter, the appraised value of real property when purchased, newly constructed, or a change in ownership has occurred after the 1975 assessment. All real property not already assessed up to the 1975-76 tax levels may be reassessed to reflect that valuation.

The initiative did not define "change in ownership." The ballot pamphlet did not define, nor did it discuss, the term "change in ownership." Because the language of the initiative failed to define this integral element, it fell to the Legislature to determine what constitutes a "change in ownership" and to define the term through legislation. Consequently, the statutory scheme defining "change in ownership" enacted after Proposition 13 passed was done without specific constitutional mandate or authorization.

Task Force on Property Tax Administration. Following the passage of Proposition 13, the Assembly Revenue and Taxation Committee appointed a task force to study existing property tax statutes in light of Proposition 13, and to recommend the appropriate changes to the Revenue and Taxation Code in light of the ambiguities of Proposition 13. The Task Force on Property Tax Administration was a broad based 35-member panel that included legislative and BOE staff, county assessors, attorneys in the public and private sectors, and trade associations. The Task Force issued its *Report of the Task Force on Property Tax Administration* to the Assembly Revenue and Taxation Committee on January 22, 1979.

Defining Change in Ownership. In defining change in ownership, the Task Force's goal was to distill the basic characteristics of a "change in ownership" and embody them in a single test, which could be applied evenhandedly to distinguish between "changes" and "non-changes." The Task Force ultimately concluded that a change in ownership is a transfer that has all three of the following characteristics:

- It transfers a present interest in real property.
- It transfers the beneficial use of the property.
- The property rights transferred are substantially equivalent in value to the fee interest.

The Legislature adopted this definition in RTC section 60. Following the recommendation of the Task Force, the Legislature also included specific examples in RTC section 61 of transfers constituting a change in ownership and specific examples in RTC section 62 of transfers not constituting a change in ownership.

Parent-Child Exclusion. The parent-child change in ownership exclusion applies to (1) a principal residence, and (2) the first $1 million dollars of adjusted base year value of all other real property. The law specifies that the exclusion applies to a transfer of real property and does not apply to transfers of interests in legal entities. However, the law provides three exceptions for transfers of interests in certain resident-owned legal entities.[4] These are:

- Cooperative housing corporations (i.e., co-ops)
- Resident-owned mobilehome parks
- Resident-owned floating home marinas

These three types of legal entities are exceptions to the assessment of legal entities under RTC section 64 in that other statutes[5] treat transfers of interests in these types of legal entities as reassessable events.

- RTC section 61(i) expressly provides that a transfer of stock in a cooperative housing corporation is a change in ownership that requires reassessment of the property, unless an exclusion applies. Thus, a cooperative housing corporation is treated as real property for change in ownership purposes and is specifically allowed by RTC section 69.5(c)(1), the over 55/disabled base year value transfer provisions.
- RTC sections 62.1 and 62.5 provide an exclusion from change in ownership for a transfer of a mobilehome park or floating home marina to an entity formed by the tenants of the park or marina to purchase their park or marina from the former owner. Once the initial conversion of a mobilehome park or floating home marina has been excluded from change in ownership, a subsequent transfer of a pro rata interest in the entity that owns the park or marina is a change in ownership. RTC sections 62.1(b)(1) and 62.5(b)(1) specifically provide that a transfer of a pro rata interest may be excluded from change in ownership under RTC section 62, 63, or 63.1.

Thus, for change in ownership purposes, transfers of interests in these types legal entities are treated similar to transfers of interests in real property.

Because the parent-child exclusion does not apply to transfers of an interest in a legal entity (except for the above exceptions), the Legislature included uncodified legislative intent language that the parent-child change in ownership exclusion be liberally construed to carry out the purpose of Proposition 58.[6] The Legislature wrote, in part, that:

> … it is the intent of the Legislature that the provisions of Section 63.1 of the Revenue and Taxation Code shall be liberally construed in order to carry out the intent … Proposition 58 on the November 4, 1986, general election ballot to exclude from change in ownership purchases or transfers between parents and their children described therein.

The legislative purpose goes on to specify that the step transaction doctrine should not apply to following types of transfers involving legal entities:

> … Specifically, transfers of real property from a corporation, partnership, trust, or other legal entity to an eligible transferor or transferors, where the latter are the sole beneficial owner or owners of the property, shall be fully recognized and shall not be ignored or given less than full recognition under a substance-over-form or step-transaction doctrine, where the sole purpose of the transfer is to permit an immediate retransfer from an eligible transferor or transferors to an

[4] RTC section 63.1(c)(8).
[5] RTC sections 61(i), 62.1(b), and 62.5.
[6] RTC section 63.1; section 2 of Stats. 1987, ch. 48 (AB 47), as amended by section 6 of Stats. 2006, ch. 224 (SB 1607).

eligible transferee or transferees which qualifies for the exclusion from change in ownership provided by Section 63.1. Further, transfers of real property between eligible transferors and eligible transferees shall also be fully recognized when the transfers are immediately followed by a transfer from the eligible transferee or eligible transferees to a corporation, partnership, trust, or other legal entity where the transferee or transferees are the sole owner or owners of the entity or are the sole beneficial owner or owners of the property, if the transfer between eligible transferors and eligible transferees satisfies the requirements of Section 63.1.

Section 2(h) of article XIII A and RTC section 63.1 were subsequently amended when Proposition 193 was approved by the voters in March 26, 1996, which provides that the parent-child exclusion also applies to transfers from a grandparent to their grandchild, where the parent of that grandchild, who is a child of the grandparent, is deceased.

Background: **Change in Ownership Exclusions.** As previously stated, the term "change in ownership" was not defined by Proposition 13. Certain definitional "exclusions," including the interspousal exclusion, were embodied in the initial statutory definitions necessary to implement Proposition 13's change in ownership provisions. Some change in ownership exclusions are contained in statute, while others are contained in the Constitution.

Since the adoption of Proposition 13, the Constitution has been amended twice to provide for additional change in ownership exclusions for certain family transfers.[7] Under specified conditions, these transfers will not trigger a reassessment of the property to current fair market value. Instead, the property retains its prior base year value.

Other constitutional amendments have been approved by voters permitting a person to "transfer" his or her Proposition 13 base year value from one property to another property, thereby avoiding reappraisal of the newly purchased property to its fair market value, if certain conditions are met. In essence, a base year value transfer is another form of a change in ownership exclusion. Those constitutional amendments include:

PROP.	ELECTION	BASE YEAR VALUE TRANSFERS	RTC
3	June 8, 1982	Replacement Property After Government Acquisition	§68
50	June 3, 1986	Replacement Property After Disaster	§69
60	Nov. 6, 1986	Persons Over 55 - Intracounty	§69.5
90	Nov. 8, 1988	Persons Over 55 - Intercounty	§69.5
110	June 5, 1990	Disabled Persons	§69.5
1	Nov. 3, 1998	Contaminated Property	§69.4

Therefore, as noted above, some change in ownership exclusions are contained in statute, while others are contained in the Constitution.

Commentary:

1. **Author's Statement.** AB 872 protects children living on a small family farm who become owners of the farm after the death of a parent from a property tax reassessment, under limited circumstances. This bill supports California's policy to help protect agricultural open space and the

[7] Proposition 58 (November 4, 1986) for transfers of real property between parents and children and Proposition 193 (March 26, 1996) for transfers from grandparents to grandchildren.

dwindling number of family farm homesteads in the state. This bill also supports the public policy to protect a person from being unable to remain in their home due to a Prop 13 reassessment trigger to current market value.

2. **Summary of Amendments.** The **July 8, 2019** amendment clarifies that this exclusion applies only to qualified property. The **June 25, 2019** amendments remove (1) the requirement that the transfer occurred between January 1, 2014 and January 1, 2020, (2) the requirement to file for the exclusion, (3) the retrospective provisions, and (4) the requirement that the only property owned by the qualified corporation is qualified property. The **April 11, 2019** amendments (1) clarify that the exclusion applies to transfers of stock that would result in a change in ownership of the qualified property owned by the qualified corporation, and (2) require the county assessor to report quarterly to the BOE all transfers for which a claim for exclusion is made and the amount of each exclusion claimed.

3. **No Filing Requirement.** This bill does not contain any filing requirement for this proposed exclusion. Existing law requires legal entities to voluntarily file a BOE-100-B, *Statement of Change in Control or Ownership of Legal Entities*, with the BOE within 90 days of a change in control or change in ownership under RTC section 64(c) or (d), to avoid a penalty. To administer the exclusion proposed by this bill, the BOE will have to either amend the BOE-100-B and instructions or create a new form and instructions.

4. **Parent-Child Change in Ownership Exclusion.** The parent-child exclusion applies to a transfer of real property and generally does not apply to a transfer of interests in a legal entity. This is consistent with California Constitution article XIII A, section 2(h), and RTC section 63.1, which provide that a change in ownership does not include the purchase or transfer of the principal residence of the transferor in the case of a purchase or transfer between parents and their children, as defined by the Legislature, and the purchase or transfer of the first $1 million of all other real property between parents and their children. While this bill is consistent with the intent of the parent-child exclusion, it is more narrow in that qualified property is a parcel of land that must contain a principal residence and have an adjusted base year value that does not exceed $1 million. Conceivably, a parent could transfer $1 million of property individually under the parent-child exclusion and another $1 million indirectly via a legal entity under the exclusion proposed by this bill. Would this new exclusion be better placed in RTC section 63.1 as part of the parent-child exclusion?

5. **Report to BOE.** This bill provides that a qualified property is a parcel of land that contains a principal residence and has an adjusted base year value that does not exceed $1 million. This bill requires county assessors to report to the BOE all transfers for which a claim for exclusion is made for qualified property pursuant to this proposed subdivision and the amount of each exclusion claimed.

   What is the purpose of requiring assessors report to the BOE on claims filed pursuant to proposed section 62(r)? This bill does not require that any claims be filed to receive the exclusion.

   What is the purpose of BOE tracking the amount of each exclusion claimed? If the purpose is for these transfers to be part of the parent-child $1 million exclusion that is tracked by the BOE (see Comment 4), then the author may want to consider clarifying this by adding a filing requirement and a cross reference to RTC section 63.1(f), and stating explicitly that any exclusion will be applied to each parent's $1 million limit. This, however, raises an issue as to how or whether the value of the principal residence should be removed for purposes of reduction of the $1 million exclusion limit for non-principal residences.

6. **Conflicting Language.** RTC section 63.1(c)(8) excludes legal entity interests from the definition of real property eligible for the parent-child exclusion. These amendments create an exclusion separate from the RTC section 63.1 exclusion.

7. **Different Laws apply to Legal Entity Ownership Interest Transfers.** Existing laws[8] prevent the parent-child exclusion from applying to a family farm homestead that includes a principal residence if the parents placed it into a corporation after they bought it and subsequently die. Thus, under this fact pattern, a family farm that includes the principal residence when passed down to the children after the parent's death will be reassessed to its current market value, despite the parent-child exclusion. This bill would allow the reversal of the reassessment of a small family homestead that has been the child's continuous place of residence, which would otherwise qualify in this limited instance on a prospective basis.

8. **Legal Entity Ownership Interest Transfer Exclusions.** Currently, the following transfers of an interest in a legal entity are not subject to reassessment:

   - Transfer of legal entity interests that do not result in (1) a change in control or (2) cumulative transfers of more than 50 percent of original co-owner interests.[9]
   - Corporate reorganization, where all of the corporations involved are members of an affiliated group.[10]
   - Transfer of legal entity interests solely between spouses or registered domestic partners.[11]
   - Transfer of legal entity interests that results solely in a change in the method of holding title.[12]

   This bill would create an additional exception from reassessment for a transfer of interest in a legal entity from parent to child, under certain circumstances.

9. **RTC Section 62 Change in Ownership Exclusions.** The exclusions currently enumerated in RTC section 62 apply to transfers of real property. This bill would create an exception in that it excludes from reassessment a transfer of an interest in a legal entity. Would this be more appropriately placed as a new subdivision in RTC section 64, which specifies the change in ownership provisions for transfers of interests in legal entities?

10. **Ambiguous Language.** RTC section 62 enumerates a list of transfers of real property excluded from change in ownership. This bill, however, states that a transfer of qualified stock is not a "change in ownership." Further, within existing property law, this language would mean excluded only from a change in ownership of a legal entity pursuant to RTC section 64(d) and would not apply to a change in control under RTC section 64(c)(1).

[8] RTC sections 62(a)(2) and 64(d).
[9] RTC sections 64(a), 64(c)(1), and 64(d).
[10] RTC section 64(b).
[11] RTC sections 63 and 62(p).
[12] Rule 462.180(d)(2).

11. **Narrow in Scope.** Under this bill, the exclusion would apply only to corporations that were created between March 1, 1975 (the effective date of Proposition 13) and November 6, 1986 (the effective date of RTC section 63.1, which implements the parent-child exclusion). Thus, this exclusion would not apply to any other type of legal entity, such as a partnership or limited liability company. In addition, we note:

    - The only corporations that would qualify would be those corporations whose only stockholders are parents and their children. A corporation that has stockholders who are grandchildren or any other persons or family members would not qualify.
    - The only transfer that would qualify is one that occurs on the parent's date of death. Voluntary transfers of interest in a legal entity would not qualify.
    - This exclusion would not apply to a reverse situation. A transfer to a parent that occurs on a child's date of death would not qualify.
    - The exclusion applies only to a parcel that contains the principal residence; the exclusion would not apply to any other parcels owned by the qualified corporation that do not contain a principal residence.

Costs: The BOE will incur costs of no more than $10,000 to reprogram the Legal Entity Ownership Program system to accommodate this new exclusion. The BOE will incur absorbable costs to amend its change in ownership statement for new exclusion. The BOE may incur an additional cost of $10,000 to create a new tracking system for this new exclusion, depending on clarification on what is to be tracked.

Revenue Impact: Given the narrow scope of Assembly Bill 872, the revenue impact is estimated to be minimal.