

Memorandum

To: Ms. Lisa Thompson
Principal Property Appraiser
County-Assessed Properties Division (MIC:64)

Date: September 4, 2015

From: Sonya S. Yim
Tax Counsel III (Specialist)
Tax and Fee Programs Division (MIC:82)

Subject: Request for Legal Opinion – Amended BOE-100-B, Statement of Change in Control and Ownership of Legal Entities for [redacted] Foundation (formerly N [redacted] Foundation) Assignment No. 15-219

This is in response to your July 2, 2015, memorandum in which you request an opinion on whether the February 12, 2012 acquisition of [redacted], LLC by [redacted] Preservation Foundation (Foundation) (formerly N [redacted] Foundation) caused a change in ownership of the real property owned by [redacted], LLC. As discussed below, we believe this transfer is excluded from change in ownership under Revenue and Taxation Code section 62, subdivision (a)(2) (section 62(a)(2)), for reasons other than those described in the taxpayer's representative's March 7, 2014 letter.

Background

At the time of the transfer in question, the [redacted] Building, a historical landmark in San Francisco, was owned by [redacted], LLC (H [redacted]). [redacted] Corporation was the sole member of H [redacted]. [redacted] Corporation, in turn, was wholly owned by a California charitable trust, The [redacted] Charitable Trust (the Trust), which had received tax exempt status under Internal Revenue Code section 501(c)(3). According to the letter from Foley & Lardner, the Foundation's representative, dated March 7, 2014 (March Letter), the Trust has broad charitable purposes—namely, the earning of investment income and the distribution of such earnings to support the activities of other charitable organizations. The trustees of the Trust believed that the maintenance and preservation of the [redacted] Building in its historic state for future generations would best be assured if the building were to be held by an organization specially organized to serve that purpose.

With that objective in mind, the trustees of the Trust organized the Foundation as a new California nonprofit public benefit corporation having as its sole purpose and function the preservation and maintenance of the [redacted] Building. Since its formation, the same three trustees of the Trust, namely J [redacted], R [redacted] and S [redacted], have served and continue to serve as the three directors of the Foundation. The Foundation also has obtained a determination of tax exempt status under Section 501(c)(3) of the Internal Revenue Code, based on its charitable and educational purposes of preserving and maintaining the [redacted] Building as a structure of historic and architectural merit. The trustees of the Trust then caused

Corporation to transfer all of its LLC interests in Holdings to the Foundation for no consideration. As a result, the three trustees of the Trust are now the three directors of Foundation, which is the sole member of H , which in turn directly owns the Building.

Law and Analysis

Article XIII A, section 2 of the California Constitution requires the reassessment of real property upon a "change in ownership," unless an exclusion applies. A change in ownership is defined in Revenue and Taxation Code section¹ 60 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."

For change in ownership purposes with regard to trusts, it is necessary to "look through" the trust to determine the parties that are receiving the present beneficial ownership of the property in the trust. (Property Tax Annotation² (Annotation) 220.0823 (November 15, 2006).) The trustee holds only bare legal title and not the present beneficial interest in the trust property, even though he or she has legal title and the power to sell the trust property. (Annotation 220.0310 (May 19, 2005).)

Section 64, subdivision (a) provides the general rule that the transfer of ownership interests in a legal entity, such as partnership interests, does not constitute a transfer of the real property owned by the legal entity. (See also Property Tax Rule³ (Rule) 462.180, subd. (c).) However, there are two exceptions to this general rule.

The first exception is set forth in section 64, subdivision (c)(1) and Rule 462.180, subdivision (d)(1), which provide that when any person or entity obtains control through direct or indirect ownership or control of more than 50 percent of the voting stock of a corporation, or of more than a 50 percent ownership interest in any other type of legal entity, all the real property owned by the acquired legal entity (and any entity under its control) will be reassessed as of the date of the change in control.

The second exception is provided in section 64, subdivision (d) and Rule 462.180, subdivision (d)(2). Those provisions state that when property is transferred to a legal entity in a transaction excluded from change in ownership by section 62(a)(2), the holders of the legal entity interests immediately after the excluded transfer become "original co-owners" for purposes of determining the change in ownership consequences of any subsequent transfers of those legal entity interests. Section 62, subdivision (a)(2) and Rule 462.180, subdivision (d)(4) exclude from change in ownership a transfer of real property (or transfer of an ownership interest in a legal entity that owns real property) between legal entities or between a legal entity and an individual that results solely in a change in the method of holding title and in which the proportional ownership interests of the transferors and transferees, in each and every piece of real property transferred, remain the same after the transfer. Subsequently, whenever ownership

¹ All subsequent section references are to the Revenue and Taxation Code unless otherwise noted.

² Property tax annotations are summaries of the conclusions reached in selected legal rulings of State Board of Equalization counsel published in the State Board of Equalization's Property Tax Law Guide. (See Cal. Code Regs., tit. 18, § 5700 for more information regarding annotations.)

³ All subsequent references to "Rules" are to the Property Tax Rules promulgated under title 18 of the California Code of Regulations.

interests representing cumulatively more than 50 percent of the total interests in the legal entity are transferred by any of the original co-owners in one or more transactions, there is a change in ownership of that real property owned by the legal entity that was previously excluded from change in ownership reappraisal under section 62(a)(2).

In this case, since the Trust began as the ultimate owner of the Building, we must "look through" the Trust to determine the parties that were receiving the present beneficial ownership of the property in the trust. (Annotation 220.0823, *supra*.) For property held in an irrevocable trust, although the trustee holds legal title, the beneficiary is deemed to be the equitable owner of the property for property tax purposes. (Annotations 880.0288 (December 31, 2007), 880.0206 (March 11, 1991).) However, a charitable trust is a gift in trust for the benefit of the public or for the establishment or support of an institution dedicated to the welfare of the public or to a class or part thereof. (15 Am.Jur.2d (2015) Charities, § 5, citing *In re Schloss' Estate* (1961) 56 Cal.2d 248.) Therefore, charitable trusts do not have ascertainable beneficiaries. (13 Witkin Summary of Cal. Law (10th ed. 2010) Trusts, § 291, citing, *inter alia*, *In re Estate of Huebner* (1932) 127 Cal.App. 244.) Thus, since the subject Trust is a charitable trust, the beneficial owners of the property in the trust are, by definition, not ascertainable.⁴

Similarly, nonprofit public benefit corporations, such as the Foundation in this case, are organized in such a way that beneficial "owners" of property held by such corporations technically do not exist. In the case of nonprofit public benefit corporations, we have previously opined that members, or if there are no members, then directors, of such organizations will be considered owners of the entity's property for property tax purposes, such that property transferred between public benefit corporations is excluded under section 62(a)(2) if the members/directors of the transferor corporation were identical to the members/directors of the transferee corporation before and after the transfer. (Annotation 220.0081 (August 5, 1983; June 2, 2010).) We reasoned that in applying section 62(a)(2) to public benefit corporations, nothing in the statutory language directly states that it applies or does not apply to public benefit corporations, and that the Joint Task Force on Property Tax Administration, when initially considering Proposition 13, did not specifically consider the change in ownership treatment of real property owned by nonprofit public benefit corporations. Similarly, we noted that the legislative history of section 62(a)(2) and section 64 demonstrate no consideration of public benefit corporations when enacting or amending those statutes. Thus, there was no apparent reason to treat public benefit corporations differently than business corporations in the taxation of real property they own, and for those reasons, we have opined since 1983 that nonprofit public benefit corporations are eligible for the section 62(a)(2) exclusion. (June 2, 2010 back-up letter to Annotation 220.0081, *supra*.) We concluded that "Although the plain language of sections 62(a)(2) and 64 each require the tracking of *ownership* interests in legal entities, it is reasonable to equate public benefit corporation membership, or directorship when there are no members, to ownership for purposes of section 62(a)(2) and section 64." (Annotation 220.0081, *supra*.)

It follows, then, that if proportional ownership interest is measured by members or by the board of directors for purposes of the section 62(a)(2) exclusion, the members or board of directors must then become "original co-owners" in the nonprofit public benefit corporation pursuant to section 64, subdivision (d), such that if a voting interest change in the members or board of directors of more than 50 percent occurs, there would be a change in ownership of the property

⁴ We assume the charitable trust is irrevocable. If the trust were revocable, beneficial ownership would lie with the trustor. (Rev. & Tax. Code, § 62, subd. (d).)

previously excluded under section 62(a)(2). (June 2, 2010 back-up letter to Annotation 220.0081, *supra*.)

In this case, in order to determine the equivalent of ownership for charitable trusts with no ascertainable beneficiaries, we note that similar to the above, there is no statutory language, legislative history, or consideration in the Joint Task Force on Property Tax Administration for Proposition 13 regarding the applicability of section 62(a)(2) to such trusts. We also note that section 62(a)(2) and section 64 have been applied to transfers through other types of trusts, based on beneficial ownership. (See, e.g., Annotation 220.0277 (October 30, 1990); Annotation 220.0375.020 (January 17, 2001).) Therefore, it is consistent with the above discussion regarding nonprofit public benefit corporations to conclude that those individuals who have responsibility and decision-making authority over the trust assets, which in this case are the trustees, should be considered the owners of the trust property for this purpose.⁵ Generally, the trustees of a charitable trust are under the duty of caring for and managing the property of the trust, and trust funds should be carefully guarded and protected, to the end that the charitable intent of the testator will be carried out. (15 Am.Jur.2d (2015) Charities, § 89.) A charitable trust is a fiduciary relationship with respect to property, and subjects the person by whom the property is held to equitable duties to deal with the property for a charitable purpose. (*Id.* [citing *Hardman v. Feinstein* (1987) 195 Cal.App.3d 157].) Trustees of charitable organizations are fiduciaries who are required to exercise ordinary and reasonable care in the performance of their duties, exhibiting honesty and good faith. (*Id.*) Substantially the same principles as to duties and liabilities govern both charitable and private trusts. (*Id.* [citing *Gbur v. Cohen* (1979) 93 Cal.App.3d 296].) Thus, in a charitable trust for which there are no ascertainable beneficiaries, there are no other individuals with responsibilities and liabilities with respect to the trust property other than the trustees, and for that reason, we believe it is reasonable to consider the trustees the owners of the property owned by a charitable trust, for purposes of the legal entity rules.

In this case, then, before the subject transaction took place, the three trustees mentioned above (J _____, R _____, and S _____) are considered the owners of the property in the _____ Trust, which wholly owned the _____ Corporation, which was the sole member of H _____, which directly owned the _____ Building. After the transaction, the same three trustees were the sole directors of the Foundation, which was the sole member of H _____, which still owned the _____ Building. As discussed above, since the trustees of the Trust are considered the owners of the property before the transaction, and the directors of the Foundation are treated as owners of the property after the transaction, the same three individuals had ultimate "ownership" over the _____ Building before and after the transaction. For that reason, this was a transaction between legal entities that resulted solely in a change in the method of holding title and in which the proportional ownership interests of the transferors and transferees remained the same after the transfer, and thereby qualifies for exclusion from change in ownership under section 62(a)(2). Pursuant to section 64, subdivision (d) and Rule 462.180, subdivisions (d)(2) and (d)(4), the Directors of the Foundation became "original co-owners" in Foundation since they are the "owners" of the legal entity to which H _____ was transferred.

⁵ We do not have a copy of the Trust. However, the legal duties of trustees are set forth hereafter.

Notably, section 64, subdivision (c)(1) provides that when any entity obtains control through direct or indirect ownership or control of more than 50 percent of the ownership interest, a change in ownership of the real property occurs. (See, e.g., Annotation 220.0100 (February 14, 1984).) In this case, a change in direct ownership of Holdings occurred. Before the transaction, H (which owned the property) was 100 percent directly owned by Corporation. After the transaction, H was 100 percent directly owned by the Foundation. This is a 100 percent change in control, which should result in a reassessment of all the real property owned by H pursuant to section 64(c)(1). However, the section 62(a)(2) exclusion takes precedence over the change in control provision of section 64(c)(1). (Annotation 220.0385.005 (January 13, 2009); see also Annotation 220.0376.005 (July 23, 2008).) For that reason, no reassessable change in ownership has occurred.

As stated in the June 2, 2010 back-up letter to Annotation 220.0081, we recognize that the plain language of sections 62(a)(2) and 64 each require the tracking of *ownership* interests in legal entities, but that a principal characteristic of public benefit corporations, and one of the principal distinctions between public benefit corporations and business corporations or other legal entities, is that public benefit corporations do not issue stock or other forms of ownership interests and, thus, members have no ownership interest in public benefit corporations.⁶ Although, as discussed above, some public benefit corporations issue "memberships," a "membership" merely refers to the rights a member has pursuant to the public benefit corporation's articles, bylaws and California's nonprofit corporation laws.⁷ Other differences between owners of stock and members of public benefit corporations are that, unless provided otherwise in the corporation's articles or bylaws, no member may transfer a membership or any right arising from the membership, and all rights of membership cease upon the member's death or dissolution.⁸ Also, while membership may be issued for no consideration or for some consideration as determined by the board,⁹ even if the articles or bylaws provide that a member may transfer a membership, in no event may that transfer be for value.¹⁰ Finally, memberships do not entitle the members to receive any distribution of current income or profits or any distributions of assets upon liquidation.¹¹

Therefore, since there is no "ownership" in a public benefit corporation, it could be argued that the plain language of section 62(a)(2), and section 64, subdivisions (a), (c), and (d) simply do not apply to nonprofit public benefit corporations and charitable trusts. However, as discussed in the back-up letter to Annotation 220.0081, *supra*, nothing in the history of the section 62(a)(2) exclusion indicates that the voters or, subsequently, the Legislature intended to disqualify all public benefit corporations from the change in ownership exclusion available to business legal entities. We note that our interpretation regarding the application of section 62(a)(2) and section 64 to public benefit corporations has been a matter of public record as far back as 1983, with no intervening contrary judicial or legislative guidance.

⁶ June 2, 2010 back-up letter to Annotation 220.0081, *supra*, at p. 6.

⁷ Corp. Code, § 5057.

⁸ Corp. Code, § 5320, subd. (a).

⁹ Corp. Code, § 5311.

¹⁰ Corp. Code, § 5320, subd. (b).

¹¹ Corp. Code, § 5410. See Ballantine & Sterling, California Corporation Laws (2015) Distributions to Members, § 408.

Finally, your memo states that APN _____ was transferred on July 12, 2011 from Corporation to Holdings. We will assume that APN _____ is the subject property. If that is the case, that transfer was excluded from reassessment under section 62(a)(2). Corporation therefore became an original co-owner in H _____ on July 12, 2011. Subsequently, when N _____ Corporation gave H _____ to Foundation, there was another exclusion from change in ownership under section 62(a)(2), which is the 2012 transaction discussed above. Since Rule 462.180(d)(2) states that "proportional transfers excluded under Revenue and Taxation Code section 62, subdivision (a)(2) shall not be cumulated or counted to determine a change in ownership,"¹² Corporation's 2012 transfer of original co-owner interests in H _____ to Foundation was excluded from change in ownership under section 62(a)(2), but the transferred original co-owner interests were not counted and cumulated for change in ownership purposes.

According to Annotation 220.0451.015, until an original co-owner interest is transferred *and* counted and cumulated for purposes of section 64(d), the interest as held by the transferee is an original co-owner interest. Therefore, if an original co-owner interest is transferred and excluded from counting and cumulating under Rule 462.180, subdivision (d)(2), the transferee takes the interest as an original co-owner. (Back-up letter to Annotation 220.0451.015 (March 15, 2012) at p. 2.) Thus, since Corporation's 2011 transfer of original co-owner interests in H _____ to Foundation were transferred but not counted and cumulated, Foundation, as the transferee, took the interest as an original co-owner. Therefore, after the subject 2012 transaction, Foundation was an original co-owner for purposes of determining the change in ownership consequences of any subsequent transfers of interests in H _____.

In conclusion, neither the 2011 transfer of the _____ Building from Corporation to H _____, nor the 2012 transfer of H _____ from Corporation to Foundation cause a change in ownership and reassessment of the _____ Building. However, as a result of those transfers, the Directors of the Foundation are original co-owners in the Foundation, and the Foundation is an original co-owner in Holdings.

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cc: Mr. Dean Kinnee (MIC:63)
Mr. Benjamin Tang (MIC:64)
Mr. Todd Gilman (MIC:70)

¹² See, e.g., Annotation 220.0451.005 (July 21, 2008).