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August 30, 1999

Office of Dick Frank, County Assessor  
County Government Center, Room 100  
San Luis Obispo, California 93408

Attention:

Assessment Analyst II

Re: Merger of M Bank and Bank of S

Dear Ms. :

This is in response to your letter of February 2, 1999, in which you request our opinion on whether or not the merger of M Bank (M) with the Bank of S (SM Bank) resulted in change in ownership for property tax purposes of the real property owned by either or both of the two banks. Pursuant to your letters, the banks owned property in both County and County. For purposes of this letter, I assume that B, the holding corporation for SM Bank, did not own real property.

**Summary of Opinion**

Pursuant to section 61(j) of the Code of Revenue and Taxation, the pre-merger real property of SM Bank that was transferred to M Bank via the merger underwent a change in ownership for property tax purposes as of the date of the merger. In addition, under section 64(c) of the Code of Revenue and Taxation, the pre-merger real property owned and retained by M underwent change in ownership upon the transfer of 100 percent of M's stock to B during the merger.

**Summary of the Merger**

To summarize this transaction, a so-called "reverse triangular merger" took place between M and SM Bank. Prior to the merger, M had 7 million outstanding, publicly held shares. B, on the other hand, held all of SM Bank's shares, as a bank stock holding corporation. Before the transaction, B had 3 million outstanding, publicly held shares. In the merger, M was the acquiring or surviving corporation, while SM Bank disappeared. SM Bank's stock -- which as indicated above was owned in full by B -- became stock in M. In addition, in consideration of the merger, B exchanged 7 million of its own shares for all of the outstanding pre-merger shares in M. More specifically, in carrying out this exchange, B issued 7 million shares of its own stock

directly to the former M shareholders. As the existing B shareholders already held 3 million shares, this stock issuance gave the former M shareholders a 70 percent interest in the post-merger ownership and control of B – which had been transformed from a holding corporation for SM Bank into a holding corporation for the post-merger M . Consequently, following the merger, B held 100 percent of the ownership and control – not in SM Corporation which did not survive the merger – but in M Bank, which now held substantially all of SM Bank’s pre-merger assets. Thus, to the extent that SM Bank’s pre-merger assets included real property, such real property was transferred to M by operation of law.”

### Law & Analysis

#### **The Transfer of SB Bank’s Real Property To M Bank in the Merger**

Section 60 of the Code of Revenue and Taxation defines “change in ownership” for property tax purposes 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 . . . .” Section 61 provides in relevant part that “[e]xcept as otherwise provided in section 62, change in ownership, as defined in section 60, includes, but is not limited to: . . . . (j) [t]he transfer of any interest in real property between a corporation, partnership or other legal entity and a shareholder, partner, or any other person.”

In this case, as a result of the merger transaction, SM Bank ceased to exist and M Bank succeeded by operation of law to all of the property of SM Bank. Thus, unless an exclusion is applicable, a change in ownership took place as to the real property that was owned by SM Bank before the merger and subsequently transferred to M via the merger. The only two exclusions that potentially might be available in this case are the exclusions provided by section 62(a)(2) and section 64(b).

Section 62(a)(2) provides that change in ownership does not include “[a]ny transfer between . . . legal entities . . . that 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 . . . .” This exclusion from change in ownership is not available in this case, however, because the post-merger stock ownership of M , the transferee, is not the same as the pre-merger stock ownership of SM Bank, the transferor.

Section 64(b) states that:

Any corporate reorganization, where all of the corporations involved are members of an affiliated group, and that qualifies as a reorganization under Section 368 of the United States Internal Revenue Code and that is accepted as a nontaxable event by similar

California statutes, or any transfer of real property among members of an affiliated group . . . shall not be a change of ownership . . .

For purposes of this subdivision “affiliated group” means one or more chains of corporations connected through stock ownership with a common parent corporation if both of the following conditions are met: (1) One hundred percent of the voting stock . . . of each of the corporations, except the parent corporation, is owned by one or more of the other corporations. (2) The common parent corporation owns, directly, 100 percent of the voting stock . . . of at least one of the other corporations.”

Since SM Bank and M Bank were not affiliated corporations within the definition of section 64(b) as set forth above, and since B was not a common parent corporation, the exclusion from change in ownership provided by this section is unavailable in this instance. Thus, as indicated above, I conclude that the SM Bank real property that was transferred to M because of the merger underwent a change in ownership as of the date of the merger.

#### **The Transfer of M Bank’s Voting Stock to B**

In consideration of the merger, B exchanged 7 million of its shares for all 7 million outstanding shares of M. Thus, at the conclusion of the merger, all of M’s shares were owned by B. In turn, B’s shares were owned 70 percent by the former M Bank shareholders and, thus, controlled by such former M Bank shareholders. In this manner, B became the bank stock holding corporation for the post-merger M.

Section 64(c) of the Code of Revenue and Taxation provides that change in ownership occurs when a corporation or any other person obtains control through direct or indirect ownership or control of more than 50 percent of the voting stock of any other corporation. In this case, B obtained control of 100 percent of the voting stock of M. Thus, under section 64(c), there is a prima facie case for change in ownership as to the pre-merger real property of M.

In a letter dated December 24, 1998, however, the Vice-President and Controller of the M Bank contends that no change in ownership occurred as to M’s pre-merger real property because “the shareholders of M Bank owned a controlling interest prior to the merger and still own a controlling 70% interest in the resulting company.” In other words, M contends that the transfer of 100 percent of its voting stock to B does not result in change in ownership of its real property because – following the merger – its pre-merger shareholders owned and controlled 70 percent of the stock in B. This contention is unavailing.

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<sup>1</sup> The section 62(a)(2) exclusion is unavailable in this case since the post-merger ownership of B is not the same as, or in proportion to, the pre-merger ownership of M.

In *Kraft, Inc. v. County of Orange* (1990) 219 Cal.App.3d 1104, the taxpayer made the same argument as M \_\_\_\_\_ makes in this case. In other words, Kraft argued that no change in ownership resulted from Kraft's stock being transferred to a holding corporation because the Kraft shareholders obtained majority control of the holding corporation. But the court found against Kraft, holding that section 64(c) was applicable because the holding company had acquired direct control of Kraft and the former Kraft shareholders had merely become individual shareholders of the holding company:

To accept Kraft's contentions would be to defeat the Legislature's express purposes....

\* \* \*

Kraft contends the "ultimate control" theory requires looking through the corporate form to determine which shareholders hold the essential element of control. Under the "ultimate control" theory, a change in property ownership occurs if a single shareholder gains majority control of a corporation through purchase of shares. Kraft argues ultimate control is not vested in [the holding corporation] because it is the former Kraft shareholders who ultimately control the property owned by Kraft.

Subdivision (a) of section 64 reflects the "'separate entity' theory, i.e., the notion found in our general law that corporations, partnerships, joint ventures, and associations have an identity apart from that of the owners." (*Sav-on Drugs, Inc. v. County of Orange* (1987) 190 Cal.App.3d 1611, 1620.) Thus, the general rule is that the transfer of corporate stock is not deemed a transfer of the real property of a legal entity because the separate legal entity still owns the property. Section 64, subdivision (c), as an exception to that general rule, reflects the "ultimate control" theory, which looks through the title holder to the entity ultimately responsible. (*Title Ins. & Trust Co. v. County of Riverside* (1989) 48 Cal.3d 84, 89-90, fn. 3.) The ultimate control theory, however, does not require, as Kraft contends, that we are to ignore all intermediary entities and look only to the shareholders of the parent company which indirectly controls the title-holding subsidiary corporation. The former Kraft shareholders are now merely individual shareholders in [the holding corporation]; and [the holding corporation] is the controlling entity.

Thus, based upon section 64(c) and the above-cited *Kraft* decision, I conclude that the transfer of 100 percent of M \_\_\_\_\_'s stock to B \_\_\_\_\_ resulted in change in ownership of the pre-merger real property owned and retained by M \_\_\_\_\_. The effective date of such change in ownership was the date of the merger.

**Conclusion**

As indicated above, based upon my analysis of the submitted material, I conclude that a change in ownership took place as to the pre-merger real property of SM Bank that was transferred to M Bank via the merger. As to the pre-merger real property owned and retained by M Bank, in my opinion the transfer of 100 percent of M's stock to B resulted in change in ownership of such property.

The views expressed in this letter are only advisory in nature, they represent the analysis of the legal staff of the Board based on present law and the facts set forth herein, and are not binding on any person or public entity. If you have any questions or comments, please call me at (916) 324-6593.

Sincerely,

*/s/ Robert W. Lambert*

Robert W. Lambert  
Senior Tax Counsel

RWL:jd

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cc:

Mr. Dick Johnson – MIC:63  
Mr. David Gau – MIC:64  
Ms. Jennifer Willis – MIC:70