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Executive Director

November 28, 1995

Re: Request for Letter Opinion

Dear Mr. Redacted

This is in response to your letter of September 25, 1995 to Mr. Richard Ochsner in which you request an opinion whether a certain proposed merger of corporations described below would constitute a “change in ownership” for California property tax purposes. The relevant facts and proposed transaction are described in your letter of September 18, 1995 to Mr. Ken Hayashi of the Sonoma County Assessor’s Office and set forth below:

RELEVANT FACTS

Description of the Entities

Corporation A is a California corporation which owns real estate in various counties of California, including Kern County. The shareholders of Corporation A, and the number of shares held by each shareholder, is identified in column C of the enclosed schedule entitled “Corporate Reorganization” (“Schedule”). All of the existing shareholders of Corporation A are also directors of Corporation A.

Corporation B is a California corporation which also owns real estate in California. The shareholders of Corporation B, and their percentage ownership of Corporation B, are identified in Column A of the Schedule. It should be noted that Corporation A is a shareholder of Corporation B, owning 44.76 percent of the outstanding shares of Corporation B. All shareholders of Corporation B are also directors, except that Corporation A is a shareholder of Corporation B, but it is not a director, and shareholder number 7 is a director but he is not a shareholder of Corporation B.

Corporation B owns 100 percent of the outstanding shares of two other corporations, which are identified for purposes of this letter as Corporations “X” and “Y.” Corporation X is a California corporation. Corporation Y is an Oregon corporation. Corporations X and Y are not referred to in the Schedule.

All of the shareholders referred to in the Schedule, except for Corporation A, are competent individual persons who have attained the age of majority and are related by blood. Two of the shareholders are brothers, and the remaining shareholders are their children.

Description of the Transaction

The shareholders of Corporations A and B desire to consolidate their affairs and merge their corporations (including Corporations X and Y) such that the resulting corporation will be identified as Corporation A. Corporation A would own all assets and be responsible for all liabilities of the corporations previously identified as Corporations B, X, and Y. For purposes of this letter, we assume, as you have represented, that the proposed series of mergers would be "tax free" mergers or "reorganizations" pursuant to Internal Revenue Code Section 368, and other relevant code sections.

The first step of the proposed transaction would be a short form California merger pursuant to which Corporations X and Y would be merged into their parent, Corporation B. Since Corporation B is the only shareholder of Corporations X and Y, there would be no exchange of shares and the stock certificates previously held by Corporation B would be canceled. All assets and liabilities of Corporations X and Y would be transferred to Corporation B.

Immediately after the merger of Corporations X and Y into Corporation B, Corporation B would be merged into Corporation A. Corporation A would issue stock to Corporation B shareholders and cancel the Corporation B stock certificates. As a result of the merger, Corporation A would acquire all assets and liabilities of Corporation B (including the assets and liabilities of Corporations X and Y that were previously merged into Corporation B). The enclosed Schedule summarizes the change of stock ownership that occurs as a result of the proposed merger of Corporation B into Corporation A.

In connection with the merger of Corporation B into Corporation A, Corporation A will issue new shares of stock to the former shareholders of Corporation B at a ratio of 8 : 5, or less (e.g., 7 : 5, 6 : 5). This ratio is based upon the approximate relative value of Corporation B to Corporation A. The number of Corporation A shares to be issued to the shareholders of Corporation B are reflected in column B of the Schedule.

Corporation A is a shareholder of Corporation B and, pursuant to the merger, would receive shares of stock of Corporation A. Corporation A would immediately retire its shares of stock in itself, and return these shares to the status of authorized but unissued shares. The resulting percentage ownership of each shareholder of Corporation A is reflected in column F of the Schedule.

Summary of Proposed Changes in Stock Ownership

The enclosed Schedule is useful in understanding the resulting changes in stock ownership as a result of the merger.

Column F indicates that Corporation A shareholders' percentage ownership ranges from 5.1 percent to 46.35 percent. No individual shareholder would acquire more than 50 percent of the stock of Corporation A as a result of the proposed merger. Thus, using a ratio of 8 : 5, no shareholder would acquire 50 percent or more of the stock of Corporation A as a result of the merger of Corporation B into Corporation A.

In addition, the Schedule shows that the total change in ownership of stock in Corporation A is less than 50 percent. Column H indicates the change in percentages between each shareholder's ownership prior to the merger and each shareholder's ownership after the merger. Although column H indicates the difference between the percentage ownership prior to and after the merger for any individual shareholder, column H does not indicate the total of these changes. However, this may be determined by adding each individual line item in column H. The aggregate change in percentage ownership, disregarding whether the change is positive or negative, is 46.92 percent. Half of this figure is from an increase and half from a decrease in percentage ownership. Thus, using a ratio of 8 : 5, the merger would not result in a change of stock ownership of more than 50 percent of the stock of Corporation A.

In the event the ratio is reduced from 8 : 5 to 6 : 5, the percentage interest held by the largest shareholder is reduced. The range of percentage ownership of the shareholders of Corporation A would range between 5.02 percent and 44.82 percent. Thus, under a ratio of 6 : 5, no single shareholder would have more than 50 percent of the stock of Corporation A subsequent to the merger.

Also, in the event a 6 : 5 ratio is used, the aggregate change in percentage ownership reflected in column H is less, i.e., 37.62 percent. Thus, using a ratio of 6 : 5, the change of stock ownership as a result of the merger would not exceed 50 percent.

Based on the foregoing facts and proposed transaction, you ask the following questions:

Question 1: Would the proposed transaction be excluded from change in ownership under Revenue and Taxation Code¹ section 64, subdivision (b)?

Generally speaking, a purchase or transfer of corporate stock does not constitute a change in ownership of the real property of the corporation of which such stock is purchased or transferred under the provisions of section 64, subdivision (a). Exceptions to this general rule, however, are found in section 64, subdivisions (c) and (d) which provide that under certain circumstances the purchase or transfer of corporate stock can result in the change in ownership of the corporation's real property. Similarly, the transfer of the real property of a corporation to another person or entity can result in a change in ownership of such property for California property tax purposes under section 60 and 61, subdivision (i).

¹ All statutory references are to the Revenue and Taxation Code unless otherwise indicated.

Section 64, subdivision (b), however, provides an exclusion from change in ownership for:

“[a]ny corporate reorganization, where all of the corporations involved are members of an affiliated group, and which qualifies as a reorganization under Section 368 of the United States Internal Revenue Code and which is accepted as a nontaxable event by similar California statutes, or any transfer of real property among members of an affiliated group. . . .”

“Affiliated group” is defined by section 64, subdivision (b) to be “one or more chains of corporations connected through stock ownership with a common parent corporation if”

- (1) One hundred percent of the voting stock, exclusive of any share² owned by directors, of each of the corporations, except the parent corporation, is owned by one or more of the other corporations; and
- (2) The common parent corporation owns, directly, 100 percent of the voting stock, exclusive of any shares owned by directors, of at least one of the other corporations.”

A California appellate court has determined that membership in an “affiliated group” must exist at the beginning and end of the transaction. Pueblos Del Rio South v. City of San Diego (1989) 209 Cal.App.3d 893.

The Pueblos court also indicated that the purpose of section 64, subdivision (b) is to exclude those transfers among corporations that are essentially under the same ownership and control before the transfer as after. Pueblos at p. 905 (quoting from California Assembly Revenue & Taxation Committee Report on Property Tax Assessment: Implementation of Proposition 13, Vol. 1 (10/29/79), p. 28).

As indicated above, the merger of Corporation B into Corporation A constitutes a transfer of the real property owned by Corporation B to Corporation A. For the reasons discussed below, such transfer, in our view, is excluded from change in ownership under section 64, subdivision (b).

First, we assume, as you have represented, that the proposed mergers qualify as reorganizations pursuant to Internal Revenue Code section 368 and “are accepted as a nontaxable event under similar California statutes . . .”

² Pursuant to section 13, we read the singular word “share” to include the plural word “shares.”

Second, the corporations are members of an affiliated group. Prior to the reorganization, each corporation (i.e., Corporation B and its subsidiaries, Corporation X and Corporation Y), except the parent (Corporation A), is 100 percent owned by one of the other corporations (i.e., Corporation B owns 100 percent of Corporations X and Y). Furthermore, the common parent corporation (Corporation A) owns 100 percent, exclusive of director owned shares, of at least one other corporation (Corporation B). This element is satisfied before the reorganization because Corporation A is the only shareholder of Corporation B when the shareholders of Corporation B who are directors of Corporation B are excluded as required by section 64, subdivision (b) in defining "affiliated group".

According to the Pueblos decision, affiliation must also exist after the reorganization. In this proposed merger, the only remaining entity is Corporation A. Obviously, affiliation with any other corporation would no longer exist. It is clear, however, that the affiliation continues through a unity of ownership between shareholders of both corporations. As indicated by a comparison of columns F and G of the Schedule, the shareholders of Corporation A before and after the proposed merger are identical. It is true that the percentages of ownership of Corporation A by the Corporation A shareholders do not remain the same before and after the transfer. It is also true that the proportional ownership interests of the Corporation A shareholders in the real property do not remain the same after the merger as would be required by section 62, subdivision (a)(2), "that the same interests be maintained after the transaction as before." Pueblos at page 906. In our view, therefore, the requirement of continuing affiliation after the merger is satisfied under the proposed transaction. This conclusion is consistent with the purpose of section 64, subdivision (b) which, as indicated above, is to exclude those transfers among corporations that are essentially under the same ownership and control before and after the transfer.

Accordingly, it is our opinion that the proposed merger of Corporation B into Corporation A involves affiliated corporations in an Internal Revenue Code section 368 reorganization, and qualifies under Revenue and Taxation Code section 64 (b) so as to exclude from change in ownership the real property transferred from Corporation B to Corporation A. Any change in ownership of the real property of Corporation A otherwise resulting from the proposed transaction would also be excluded from change in ownership for the same reason.

Similarly, even if the proposed reorganization doesn't qualify under section 368 of the Internal Revenue Code and related to California statutes, the transfer of Corporation B's real property to Corporation A by merger would be excluded under section 64, subdivision (b) as a transfer of real property between affiliated corporations.

Since no transfer of Corporation A's real property would occur and since, as discussed below, section 64, subdivisions (c) and (d) are not applicable to the transfer of Corporation A stock under the proposed transaction, there would be no change in ownership of Corporation A's real property even if section 64, subdivision (b) were inapplicable.

You correctly point that if the answer to your first questions is answered in the affirmative, then questions 2 and 3 are moot. Notwithstanding our affirmative answer to your first questions, however, we will nevertheless address questions 2 and 3.

Question 2: Would the proposed transaction result in a change in ownership of the property owned by Corporation A and Corporation B pursuant to section 64, subdivision (c).?

Section 64, subdivision (c) generally provides that when any person or entity obtains more than 50 percent of the voting stock of any corporation through the purchase or transfer of such stock, such purchase or transfer of that stock shall be a change in ownership of the real property owned by the corporation in which the controlling interest is obtained.

First, the merger of Corporations X and Y into Corporation B does not involve the purchase of transfer or any corporate stock. Corporation B already owns 100 percent of the stock of both corporations, and will merely cancel the stock that it owns.

Second, with respect to the merger of Corporation B into Corporation A, no person or entity would obtain more than 50 percent of the stock of Corporation A as shown in column F of the attached Schedule. Also, no person or entity would obtain more than 50 percent of the stock of Corporation B as Corporation A will cancel the Corporation B stock.

Accordingly, there would be no change in ownership under section 64, subdivision (c) of the real property of Corporation A or Corporation B.

Question 3: Would the proposed transaction result in a change in ownership of the real property owned by Corporation A pursuant to section 64, subdivision (d)?

Section 64, subdivision (d) generally provides that a transfer of shares in a corporation representing cumulatively more than 50 percent of the total interests in the corporation by any of the original coowners, results in a change in ownership of the real property which was previously excluded from change in ownership under the provisions of section 62, subdivision (a) (2).

The statute defines "original co-owners" as the persons holding ownership interests in the corporation if property is transferred on or after March 1, 1975 to the corporation and it is excluded from a change in ownership by paragraph 2 of subdivision (a) of section 62.

In this case, you have stated that the real property owned by Corporation A was transferred to Corporation A prior to March 1, 1975. Original coowner status depends upon the real property having been transferred to the entity on or after March 1, 1975. Since that did not occur here, the holders of the shares in corporation A are not original coowners for purposes of section 64, subdivision (d) and, therefore, no change in ownership of the real property of Corporation A would occur under that provision as a result of the proposed merger.

November 28, 1995

CONCLUSION

Based upon the foregoing facts and analysis, we conclude that the proposed merger, as described above, would not result in a change in ownership of the real property of Corporation A or Corporation B.

The views expressed in this letter are, of course, only advisory in nature. They are not binding upon the assessor of any county. You may wish to consult the appropriate assessor in order to confirm that the described property will be assessed in a manner consistent with the conclusions stated above.

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.

Sincerely,

Eric. F. Eisenlauer
Senior Tax Counsel

EFE:ba

cc: Honorable James W. Maples
Kern County Assessor
1115 Truxtun Avenue
Bakersfield, CA 93301

Mr. John Hagerty – MIC: 63
Mr. Dick Johnson – MIC: 64
Ms. Jennifer Willis – MIC: 70

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CORPORATE REORGANIZATION

Corporation 'A' shares currently issued and outstanding	251.0770
Shares of stock to be issued to Corporation 'B' shareholders at 8:5 ratio	401.7232
Shares of stock for Corporation 'A' issued after reorganization, including shares due to Corporation 'A'	652.8002
Total shares of stock of Corporation 'A' issued and outstanding after reorganization, not including retired shares due to Corporation 'A'	472.9732

	A	B	C	D	E	F	G	H
Shareholders	Percent Ownership of Corp B	Proposed # of Shares to be Issued of Corp A @8:5	Number of Existing Shares in Corp A	After Shares are Issued: Total # of Shares in Corp A	Post Merger Percent Ownership of Corp A	Post Merger % Ownership of Corp A after retiring Corp A shares	Pre Merger Percent Ownership of Corp A	Percent Change Between F & G
Corporation A	0.4476	179.8270	0.0000	179.8270	0.2755	0.0000	0.0000	0.0000
Stockholder #1	0.3196	128.3767	90.8385	219.2152	0.3358	0.4635	0.3618	0.1017
Stockholder #2	0.0466	18.7039	6.9400	25.6439	0.0393	0.0542	0.0276	0.0266
Stockholder #3	0.0466	18.70.9	6.9400	25.6439	0.0393	0.0542	0.0276	0.0266
Stockholder #4	0.0466	18.7039	6.9400	25.6439	0.0393	0.0542	0.0276	0.0266
Stockholder #5	0.0466	18.7039	6.9400	25.6439	0.0393	0.0542	0.0276	0.0266
Stockholder #6	0.0466	18.7039	6.9400	25.6439	0.0393	0.0542	0.0276	0.0266
Stockholder #7			77.3385	77.3385	0.1185	0.1635	0.3080	(0.1445)
Stockholder #8			24.1000	24.1000	0.0369	0.0510	0.0960	(0.0450)
Stockholder #9			24.1000	24.1000	0.0369	0.0510	0.0960	(0.0450)
Totals	1.0000	401.7232	251.0770	652.8002	1.0000	1.0000	1.0000	0.0000