(916) 445-4588

August 5, 1983

Dear Mr. B

This is in response to your letter of March 29, 1983, regarding the application of change in ownership rules to property transfers between related on profit public benefit corporations involving the E and the R . I hope you will excuse the delay in responding. As you recall the original letter was inadvertently misplaced and we needed to get copies before we responded.

Your letter included a letter from B attorney for the E group in which he explained that the E is a California public benefit corporation operating a general acute care hospital in Riverside County. It is the sole member of R , also a California public benefit corporation. Thus, the relationship between E and R is in the nature of a parent-subsidiary association between two entities. As described by Mr. the Board of Directors of E contemplates the transfer of real property from E to R for management purposes, and perhaps the creation of additional public benefit corporations each of which would in a subsidiary relationship to a proposed public benefit parent corporation. He suggests that these transfers would be exempted from change in ownership under Section 64(b) and indicates that they had obtained such a ruling from the Los Angeles County Assessor's Office.

It is my opinion that the proposed transfer from E to R would not result in a change in ownership; however, I do not believe that Section 64(b) is the applicable section. By its express terms, Section 64(b) does not apply

to nonprofit public benefit corporations but only to corporations which have stock. Rather, I believe the proposed transfer from E to R would be excluded from change in ownership by Section 62(a)(2) as a transfer between entities without a change in the proportional ownership interests.

I also believe that transfers by and between the other entities proposed to be created would meet the tests of exclusion. My conclusion is based on the assumption the facts as outlined above with respect to the relationship between E and its subsidiaries will remain the same. The exclusion will apply even with the creation of a new parent if the members of the new parent are identical with the members of E . It would be best, however, if we had the opportunity to express our opinion on the exact transaction when the new parent is to be created. The description in Mr. B letter seemed a little tentative.

Very truly yours,

Lawrence A. Augusta
Assistant Chief Counsel

LAA:jlh

cc: Mr.

bc: Mr. Gordon P. Adelman
Mr. Robert H. Gustafson
Mr. Verne Walton
Legal Section

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June 2, 2010

Honorable
County Assessor

Re: Merger of Medical Center and Memorial Hospital
Assignment No: 09-223

Dear Mr. :

This is in response to a memorandum from Lisa Thompson, Principal Property Appraiser with the Board of Equalization's County-Assessed Properties Division (CAPD), through which she forwarded your letter requesting our opinion as to whether the merger of Medical Center (Center) and Memorial Hospital (Hospital), both California nonprofit public benefit corporations,[1] resulted in a change in ownership of the properties of the merged entities. You also ask general guidance as to the application of Revenue and Taxation Code[2] section 64 and Property Tax Rule (Rule) 462.180 to this merger.

As explained in more detail below, it is our opinion that the merger of Center into Hospital (Merger) resulted in the transfer, by operation of law, of all of Center's assets to Hospital, including any California real property held by Center. However, the transfer of any real properties as a result of the Merger are excluded from change in ownership under section 62, subdivision (a)(2) (section 62(a)(2)), if the members of Center were identical to the members of Hospital both before and after the merger. In the event that Center and Hospital do not have members, section 62(a)(2) applies if the Center board of directors was identical to the Hospital board of directors both before and after the Merger. In the event that the Merger qualifies for the section 62(a)(2) exclusion, the members or the board of directors would be "original co-owners" in the surviving entity pursuant to section 64, subdivision (d).

Facts

Prior to the Merger, Health Group (--HG), a California nonprofit public benefit corporation, asserted that it was the sole member of both Center and Hospital. The Merger occurred on May 20, 2005, with Hospital being the surviving corporation. The Merger qualified under Internal Revenue Code (IRC) section 368(a)(1)(A), and the correlative California statute, as

[1] For ease of reference, nonprofit public benefit corporations are also referred to as public benefit corporations, or simply as corporations throughout this letter.
[2] All further statutory references are to the Revenue and Taxation Code unless otherwise specified.

a statutory merger and was, thus, nontaxable for income tax purposes. After the Merger, --HG asserted that it remained the sole member of Hospital.

Based on the Articles of Incorporation of the entities, you have expressed doubt that --HG was the sole member of both entities before and after the merger. In fact, you question whether either entity was authorized to have any members. Because we do not have all of the relevant documents, including all the Articles of Incorporation and the Bylaws, we make no determination as to whether or not --HG was the sole member of the entities before and after the merger.

Law & Analysis

As you know, section 60 defines a change in ownership as: (1) a transfer of a present interest in real property, (2) including the beneficial use thereof, (3) the value of which is substantially equal to the value of the fee interest. Section 61, subdivision (j) states that the transfer of any interest in real property between a corporation, partnership, or other legal entity and a shareholder, partner, or any other person is a change in ownership. Similarly, Rule 462.180, subdivision (a) states that the transfer of any interest in real property to a corporation, partnership, limited liability company, or other legal entity is a change in ownership of the real property interest transferred. Because nonprofit public benefit corporations are legal entities, transfer of real property to or from them result in a change in ownership of the real property transferred unless an exclusion applies.

IRC section 368 governs tax-free reorganizations for purposes of federal income tax. IRC section 368(a)(1)(A) addresses statutory mergers or consolidations effected pursuant to statute or statutes necessary to effect the merger or consolidation, in which, as a result of the operation of such statute or statutes, all of the assets and liabilities of a target corporation transfer to an acquiring corporation and the target corporation ceases to exist.[3] In exchange, target corporation shareholders receive stock in the acquiring corporation. Such a reorganization is sometimes referred to as a "statutory merger" or an "A reorganization."

California Corporations Code section 6010 authorizes two public benefit corporations to merge. Corporations Code section 6020, subdivision (a) states:

> Upon merger pursuant to this chapter the separate existences of the disappearing parties to the merger cease and the surviving party to the merger shall succeed, without other transfer, to all the rights and property of each of the disappearing parties to the merger and shall be subject to all the debts and liabilities of each and trust obligations upon the property of a disappearing party in the same manner as if incurred by the surviving party to the merger.

Therefore, pursuant to the terms of the California Corporations Code under which the Merger was effectuated, as a result of the Merger, the assets of Center were transferred to Hospital by operation of law.[4] Pursuant to sections 60 and 61, subdivision (j) and Rule 462.180, subdivision (a), the transfer of property from one legal entity to another is a change in ownership of such property transferred. Therefore, the transfer of any California real property to Hospital as a result of the Merger resulted in a change in ownership of that property. However, as you

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[3] 26 C.F.R. § 1.368-2(b)(1)(ii) (2009).

[4] We do not have a copy of the merger of plan but make the assumption that the merger was conducted pursuant to these sections of the Corporation Code governing the merger of public benefit corporations.

may know, we have opined in the past that the section 62(a)(2) exclusion is available to public benefit corporations. Accordingly, as discussed more fully below, the transfer at issue would be excluded from a change in ownership if the individuals serving as members or on the board of directors of Center are the same as the members or directors of Hospital before and after the merger.

Section 62(a)(2) Applicable to Nonprofit Public Benefit Corporations

Section 62(a)(2) provides an exclusion for transfers of real property that might otherwise result in a change in ownership under section 61, subdivision (j). Section 62(a)(2) excludes from change in ownership:

> Any transfer between an individual or individuals and a legal entity or between legal entities, such as a cotenancy to a partnership, a partnership to a corporation, or a trust to a cotenancy, 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.

Thus, a transfer that would otherwise result in a change in ownership under section 61, subdivision (j) may be excluded if the proportional ownership interests remain the same before and after the transfer.

In applying section 62(a)(2) to public benefit corporations, we first note that nothing in the statutory language directly states that it applies or does not apply to public benefit corporations. We believe 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, the legislative history of section 62(a)(2) and section 64 demonstrate no consideration of public benefit corporations when enacting or amending those statutes.[5] Thus, there is no apparent reason to treat public benefit corporations differently than business corporations in the taxation of real property they own. For these reasons, in the past, we have opined that nonprofit public benefit corporations are eligible for the section 62(a)(2) exclusion.

In Property Tax Annotation (Annotation) 220.0081 (August 5, 1983), we addressed the direct transfer of real property from one public benefit corporation to another. In the facts giving rise to that annotation, the transferor public benefit corporation (E) was the sole member of the transferee public benefit corporation (R). We opined that the transfer could not qualify for exclusion under section 64, subdivision (b) because "[b]y its express terms, Section 64, subdivision (b) does not apply to nonprofit public benefit corporations but only to corporations which have stock." Instead, we opined that the transfer would qualify for exclusion under section

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[5] The only exclusion from change in ownership, of which we are aware, specifically for public benefit corporations is section 62, subdivision (k). That section excludes from change in ownership a transfer of real property from one public benefit corporation to another that would otherwise result in a change in ownership under section 61, subdivision (j), where both the transferor and transferee are "regulated by laws, rules, regulations, or canons of the same religious denomination." This exclusion is broader than the section 62(a)(2) exclusion as applied to public benefit corporations and operates regardless of whether the individuals serving as members or on the board of directors are the same before and after the transfer.

62(a)(2) as a proportional ownership interest transfer because the relationship between E and R was in the nature of a parent-subsidiary association between two entities since E was the sole member of R. In other words, the measure of the test for proportionality was whether the members of R were the same as the ultimate members of E.

In Annotation 220.0065 (April 19, 1988), we opined that two public benefit corporations that did not share the same kind of parent-subsidiary association as existed in Annotation 220.0081 did not qualify for the section 62(a)(2) exclusion upon merger. Annotation 220.0065 notes that the membership of the two public benefit corporations merely overlapped (i.e., was not identical). We believe that had the respective members been identical, the transfer would have been excludable under section 62(a)(2).

Additionally, in a September 14, 1993 opinion letter that was not annotated (1993 letter), we opined that a transfer of California real property from one public benefit corporation to another would be excluded from change in ownership under section 62(a)(2) as a proportional ownership interest transfer so long as the membership of both corporations was the same both before and after the transfers. In other words, in the 1993 letter, we equated membership with ownership as follows:

> The theory behind such interpretation is that the holders of the ownership interests in nonprofit legal entities are the **membership**, generally consisting of a single voting class of members which composes its board of directors, rather than shareholders, partners, or other types of "owners" as in for-profit organizations. … [F]or purposes of determining whether a transfer of real property interests between two nonprofit corporations will result in exactly the same proportional "ownership interests" following the transfer per Section 62(a)(2), we conclude that the same persons must be **members** of each organization immediately before and after the transfer.[6] (Emphasis in original.)

We note that a public benefit corporation may have no members. If a public benefit corporation is to have members, the articles or bylaws must so provide, and in the absence of any such provision, it will have none.[7] Every public benefit corporation, however, must have a board of directors.[8] When the directors are also the only members, the corporation is treated as if it has no members,[9] and any actions that would require approval of the members require only approval of the board.[10] Thus, in the 1993 letter, we equated directorship with stock ownership in the absence of membership. Therefore, where public benefit corporations have no members, if the transferee and transferor corporations have identical boards of directors before and after the transfer, a transfer of real property from one to the other may qualify for the exclusion under section 62(a)(2). In both cases, whether ownership is equated to membership or directorship, the percentage of ownership would be measured by the member's or the director's voting interest percentage.

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[6] September 14, 1993 letter, pp. 3-4.
[7] Corp. Code, § 5310, subd. (a).
[8] Corp. Code, § 5210.
[9] Corp. Code, § 5310, subd. (c).
[10] Corp. Code, § 5310, subd. (b).

Application of Section 64, Subdivision (d) to Public Benefit Corporations

Notably missing from any of the opinions referenced above is the application of section 64, subdivision (d) after a transfer has been excluded under section 62(a)(2). Section 64, subdivision (d) provides the following:

> If property is transferred on or after March 1, 1975, to a legal entity in a transaction excluded from change in ownership by paragraph (2) of subdivision (a) of Section 62, then the persons holding ownership interests in that legal entity immediately after the transfer shall be considered the "original coowners." Whenever shares or other ownership interests representing cumulatively more than 50 percent of the total interests in the entity are transferred by any of the original coowners in one or more transactions, a change in ownership of that real property owned by the legal entity shall have occurred, and the property that was previously excluded from change in ownership under the provisions of paragraph (2) of subdivision (a) of Section 62 shall be reappraised.

Thus, 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 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 previously excluded under section 62(a)(2). For example, if two public benefit corporations merge and they had the identical same five members before and after the merger, any real property transferred in the merger would be excluded from change in ownership under section 62(a)(2), and as a result, the five members would become original co-owners. Subsequently, if 3 of the 5 members changed, more than 50 percent of the voting interest would have changed, and a change in ownership of the previously excluded property would result.

Section 64, subdivision (a) and section 64, subdivision (c)(1)

Since we have equated membership or directorship with ownership, that principle must then also be applied to section 64, subdivisions (a) and (c)(1). Thus, any change in membership or change in the board of directors would not trigger a change in ownership of the property owned by the public benefit corporation. Section 64, subdivision (a) provides that:

> the purchase or transfer of ownership interests in legal entities, such as corporate stock or partnership or limited liability company interests, shall not be deemed to constitute a transfer of the real property of the legal entity.

However, if a single member or director obtained more than 50 percent of the voting interest, the entity would undergo a change in control pursuant to section 64, subdivision (c)(1) which provides that:

> When a corporation, partnership, limited liability company, other legal entity, or any other person obtains control through direct or indirect ownership or control of more than 50 percent of the voting stock of any corporation, or obtains a majority ownership interest in any partnership, limited liability company, or other legal

> entity through the purchase or transfer of corporate stock, partnership, or limited liability company interest, or ownership interests in other legal entities, including any purchase or transfer of 50 percent or less of the ownership interest through which control or a majority ownership interest is obtained, the purchase or transfer of that stock or other interest shall be a change of ownership of the real property owned by the corporation, partnership, limited liability company, or other legal entity in which the controlling interest is obtained.

Section 64, Subdivision (b) Not Applicable to Public Benefit Corporations

Although we have equated membership in a public benefit corporation to ownership in a legal entity, section 64, subdivision (b) does not apply to public benefit corporations. That section excludes from change in ownership a reorganization that qualifies as nontaxable under IRC section 368 and under California law, but only if all corporations involved are "members of an affiliated group." Section 64, subdivision (b) also excludes from change in ownership a direct transfer of real property among members of an affiliated group. Subdivision (b) defines "affiliated group" as "one or more chains of corporations connected through *stock* ownership with a common parent corporation" (emphasis added) where both of the following conditions are met: (1) one hundred percent of the voting *stock* (exclusive of any share 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 shares owned by the directors) of at least one of the other corporations.

It is our opinion that two or more public benefit corporations cannot meet the definition of an affiliated group because they do not issue stock, and therefore, cannot be connected through *stock* ownership.[11] (See Annotation 220.0081 (August 5, 1983).)

Other Considerations

We recognize that equating membership to ownership involves measurements of changes in membership or directorship that present administrative and reporting challenges for both nonprofit benefit corporations and assessors. We also 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.[12] 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.[13] 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

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[11] For purposes of section 64, subdivision (b), a public benefit corporation may be affiliated with other business corporations, but *only* where the public benefit corporation is the common parent corporation and it owns 100 percent of the voting stock of the business corporations, directly or indirectly.

[12] Chew, Directors' and Officers' Liability (PLI 1993), § 7.2.2[A]; Introduction to Revised Model Nonprofit Corporation Act, American Bar Assn. (1988), pp. xxiv-xxix.

[13] Corp. Code, § 5057.

membership, and all rights of membership cease upon the member's death or dissolution.[14] Also, while membership may be issued for no consideration or for some consideration as determined by the board,[15] even if the articles or bylaws provide that a member may transfer a membership, in no event may that transfer be for value.[16] Finally, memberships do not entitle the members to receive any distribution of current income or profits or any distributions of assets upon liquidation.[17]

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. If such were the case, any transfer of property from one public benefit corporation to another would result in a change in ownership of that property under section 61, subdivision (j), and there would be no exclusions from change in ownership available. Moreover, under such an analysis, section 64, subdivision (a) and section 64, subdivision (c)(1) would then have no application to public benefit corporations, and a change of members or board of directors would never cause a change in control of the corporation even when one director or member has more than a 50 percent voting interest. While such an alternative interpretation of section 62(a)(2) and section 64 would have the advantage of being simpler to administer because no tracking of membership and board of director changes would be necessary, such a reading would disqualify all public benefit corporations from the change in ownership exclusion available to business legal entities. As discussed above, nothing in the history of the section 62(a)(2) exclusion indicates that the voters or, subsequently, the Legislature intended such disparate treatment.

In sum, 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. In the absence of any intervening contrary judicial or legislative guidance, and because of the likely reliance placed on our interpretation by nonprofit public benefit corporations for 27 years, we affirm our opinion that it is reasonable to equate public benefit corporation membership to ownership for purposes of section 62(a)(2) and section 64. Finally, we note that equating membership interests in public benefit corporations with ownership interests in other legal entities is generally consistent with the statutory scheme that governs legal entities that has developed since the passage of Proposition 13.

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.

Sincerely,

Richard S. Moon
Tax Counsel IV

[14] Corp. Code, § 5320, subd. (a).
[15] Corp. Code, § 5311.
[16] Corp. Code, § 5320, subd. (b).
[17] Corp. Code, § 5410. See Ballantine & Sterling, California Corporations Laws (2008) Distributions to Members, § 408.

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cc: Mr. David Gau MIC:63
Mr. Dean Kinnee MIC:64
Mr. Todd Gilman MIC:70
Ms. Lisa Thompson MIC:64