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September 25, 1985

In your letter of September 11, 1985, you request our opinion whether a change in ownership would occur under the following facts described in your letter:

The corporation is owned by in excess of 12 shareholders. The proposal is to sell the corporation and transfer the real property into the names of the individual shareholders as tenants in common in the same proportional interest.
Question:

1. As the facts above stated, is the transfer of the property from the corporation to the individual shareholders as tenants in common a change of ownership?
2. If some of the tenants in common thereafter purchase the ownership interests of the other tenants in common, to what extent, if any, is there a change of ownership?

Analyzing the proposal a step at a time, the results are as follows:

1. The transfer from the corporation to the shareholders in the same proportional interest would be excluded from change in ownership under Revenue and Taxation Code* Section 62(a)(2) provided the proportional ownership interests of the shareholders in each and every piece of real property transferred remained the same after the transfer. For example, if each shareholder owns an equal number of shares and the corporation transfers three parcels of real property to them, Section 62(a)(2) requires that each of the twelve shareholders receives a 1/12 tenancy in common interest in each of the three parcels of real property.

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

September 25, 1985

2. If some of the tenants in common thereafter purchase the ownership interests of the other tenants in common, Section 65.1 provides that only the interest transferred shall be reappraised subject to a de minimis exception not applicable here.

Thus, if each of three tenants in common in the example discussed above were to buy a 1/12 interest in one of the three parcels of real property from each of the remaining eleven tenants in common so that each of the three had total ownership of one of the three parcels, there would be a reappraisal as to 11/12 of each parcel. Of, if the three were to acquire interests so that they each own an undivided 1/3 interest as a tenant in common in each of the three parcels, there would be a reappraisal as to 3/4 of each parcel.

If, however, the parties intended from the outset to transfer the three corporate properties to the three shareholders either as individual owners of each property or tenants in common, it is likely that the assessor would make a 100 percent reappraisal of each parcel of real property. The rationale for such action is the well settled rule of tax law that the incidence of taxation depends upon the substance of the transaction. Commissioner of Internal Revenue v. Court Holding Co. (1945) 324 US 331. This general principle was further explained by the Supreme Court in an income tax context at page 334:

"The tax consequences...are not finally to be determined solely by the means employed to transfer legal title. Rather, the transaction must be viewed as a whole, and each step, from commencement of negotiations to the consummation of the sale, is relevant. A sale by one person cannot be transformed for tax purposes into a sale by another by using the latter as a conduit through which to pass title."

To similar effect is the statement of the Tax Court in Kimball-Diamond Milling Company (1950) 14 TC aff'd, 187 Fed. 2d 718; cert. denied, 70 S. Ct. 50 at page 80:

"Where the essential nature of a transaction is the acquisition of property, it will be viewed as a whole, and closely related steps will not be separated either at the instance of the taxpayer or the taxing authority. (Citations omitted.)"

September 25, 1985

The rule that substance rather than form should determine tax liability is also the law in California. Wells Fargo Bank v. Cory (1980) 110 Cal.App.3d 242, 246; Estate of Gill (1971) 19 Cal.App.3d 496, 502; Estate of Craycroft (1961) 191 Cal.App.2d 436, 443.

Under the foregoing principles, we believe the assessor would view the transaction, in substance, as a transfer from the corporation directly to the shareholders who ultimately receive the real property which would require a 100 percent reappraisal under Section 61(1). Since the proportional ownership interests would not remain the same after the transfer as they were before the transfer, Section 62(a)(2) would not apply.

If you have any further questions concerning this matter, please let us know.

Very truly yours,

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