STATE OF CALIFORNIA

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April 19, 2007

Attorney at Law

Re: Partnership - Change in Ownership

Dear Mr. :

This is in response to your June 19, 2006 fax addressed to Chief Counsel Kristine Cazadd, your June 26, 2006 fax to Acting Assistant Chief Counsel Robert Lambert, and your October 18, 2006 letter to me, requesting our opinion as to whether or not a change in ownership of certain properties occurred upon one of the owner's death.

Factual Background

In your submissions, you state that B and S owned and managed 34 pieces of real property. One of the properties was acquired by the partnership in 1943, another in 1958, another in 1968, and the remaining properties after 1979. Legal title to each of the properties was held by B and S either as joint tenants or tenants-in-common. You state that B and S formed a partnership to manage and operate the properties, and that while no written partnership agreement exists, other records sufficiently evidence the existence of a partnership between B and S (the partnership). You further state that such records include partnership bank statements, correspondence from third parties addressed to the partnership, and federal income tax returns filed by the partnership for each of the last eight years.[1] You also state that the partnership income tax returns list the properties in question as being the assets of the partnership. The partnership Schedule K-1s (which you have provided for years 1998 through 2002) indicate that profits are to be distributed 50 percent to each partner, but that partnership capital is owned 49.9999630 percent by B and 50.0000370 percent by S.

In your October 18, 2006 letter, you state that the percentage of partnership profits should have matched the percentage of partnership capital set forth in the tax returns but that due to a mistake, profits had been shared 50 percent each by B and S. You have provided the following documents as evidence of this ownership arrangement:

[1] You have not provided these documents to us for our review. Thus, this opinion assumes that such documents do in fact exist and show the facts that you assert.

1. A declaration from H K , B & S's long-time accountant.[2]

2. A declaration from S in which she states that she had a slight majority share since she was responsible for the day-to-day management of the properties, that the partnership's computer and data were kept at S's house, and that tenants directed their correspondence to S's address.

3. A check dated April 7, 1997 from the account of (S) and , M.D. (B), for $50,000 for estate taxes, made out to the Internal Revenue Service (IRS). In S's declaration, she asserts that this amount was owed to the IRS for estate taxes due on the estate of S's late mother, which were an obligation of the partnership. S also asserts that, although both her and B's name is on the check, that B's name was on the account for her convenience and that this was her private account to which only she contributed funds. Thus, she contributed $50,000 more into the partnership than B.

4. A letter from E L , S's mother's attorney, who explains that the $50,000 was a contribution to the partnership since the partnership assets were the subject of a lien securing the payment of S's mother's estate taxes.

In 2003, B died and S inherited all of B's property, including B's interest in the partnership.[3] At that time, the county assessor (the Assessor) reassessed the properties located within his county, asserting that a change in ownership of the properties occurred upon B's death. In your opinion, the Assessor erred in making its change in ownership determination. Your view is that while there was no formal partnership agreement, evidence shows that a partnership between B and S did in fact exist, and thus, B's partnership interest passed to S upon B's death. Since S owned a majority ownership interest in the partnership prior to B's death, your view is that such a transfer is excluded from change in ownership pursuant to Revenue and Taxation Code[4] section 64, subdivision (c)(2).

You ask the following two questions:

(1) Is there enough evidence to conclude that a partnership existed between B and S for property tax purposes?

(2) If so, was there a change in ownership of the subject properties as the result of B's death and S's inheritance of B's property?

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[2] You provided two declarations from H K , one dated October 13, 2006 and the second dated November 2006. Both declarations are identical with the exception that the second declaration corrects a clerical error made in the first declaration misstating the partnership percentages. The partnership percentages stated in the second declaration matches the Schedule K-1's percentage interest in partnership capital of 50.000037.

[3] You stated in a telephone conversation with me that S inherited all of B's property as a result of a holographic will written by B leaving all of his property to S. Our opinion is based on the assumption that the will is valid. To the extent the will is not valid or it passes B's property in a manner differently than you have asserted, our opinion may be different.

[4] All further statutory references are to the Revenue and Taxation Code unless otherwise specified.

As explained in further detail below, subject to the accuracy and completeness of the presumed facts, the Assessor may find that there is sufficient evidence to find that a partnership existed between B and S. Further, the Assessor may find that there is sufficient evidence to determine that S owned a majority interest in the partnership capital and profits prior to B's death, and thus, that a change in ownership of the property owned by the partnership did not occur upon B's death. In this case, both issues are primarily factual ones; and, therefore, within the county assessor's authority to determine. This is because each assessor is charged with the responsibility of locating, determining the ownership of, and assessing the taxable property within his or her respective county.

Legal Analysis

Issue 1 – Partnership

While the owner of the legal title to property is presumed to be the owner of the full beneficial interest, this presumption may be rebutted by clear and convincing proof. (Evid. Code, § 662.) The courts define clear and convincing proof as evidence "so clear as to leave no substantial doubt in the mind of the trier of fact," and as evidence "sufficiently strong to command the unhesitating assent of every reasonable mind." (*Tannehill v. Finch* (1986) 188 Cal.App.3d 224, 228; *Lillian F. v. Superior Court* (1984) 160 Cal.App.3d 314, 320; *Sheehan v. Sullivan* (1899) 126 Cal. 189, 193.) Property Tax Rule[5] 462.200, subdivision (b)(2) sets forth the types of documentary proof that may constitute clear and convincing evidence sufficient to rebut the deed presumption, and provides that the best evidence is established by "an adjudication of the existence of the factor reflected in a final judicial finding, order, or judgment." Other documents that may be presented as evidence include written documents such as tax returns, canceled checks, and insurance policies. (Property Tax Rule 462.200, subd. (b)(2).)

In your case, B and S held the legal title to 34 parcels of property either as tenants-in-common or as joint tenants, creating a rebuttable presumption that B and S were the beneficial co-owners of the properties. This presumption must be overcome by clear and convincing evidence.

Although no partnership agreement between B and S exists, a written agreement is not required. Instead, Corporations Code section 16202, subdivision (a) provides that, "the association of two or more persons to carry on as coowners a business for profit forms a partnership. . . ." And no particular formalities are required. (*Page v. Page* (1962) 199 Cal.App.2d 527.) Although B and S commonly own property and share profits, in determining whether a partnership is formed, common ownership of property does not, by itself, establish a partnership, even if the coowners share profits. (Corp. Code, § 16202, subd. (c)(1).) Neither does the sharing of gross returns. (Corp. Code, § 16202, subd. (c)(2).) But the sharing of profits does create a presumption that a partnership exists. (Corp. Code, § 16202, subd. (c)(3).) Clearly, in this case, B and S shared profits as evidenced by the provided Schedule K-1s.

[5] All references to Property Tax Rule or Rule are to title 18 of the California Code of Regulations.

Further, in determining whether a partnership is formed, the intention of the parties is the ultimate test. (9 Witken, Summary of Cal. Law (10th ed. 2005) Partnership, § 25, p. 600.) The parties need not designate their relationship as a partnership. The intent of the parties can be deduced from the partnership agreement as well as the surrounding circumstances. (*In re Foreman's Estate* (1969) 269 Cal.App.2d 180.) Where, as here, no partnership agreement exists, intent to form a partnership is deduced from the parties' conduct, transactions, and declarations. (*Kloke v. Pongratz* (1940) 38 Cal.App.2d 395.)

You state that the filing of partnership tax returns, the existence of partnership bank statements, correspondence from third parties addressed to the partnership, declarations by S and Mr. K , B and S's long-time accountant, as well as a $50,000 check you claim was paid by S for partnership expenses, clearly evidence B and S's intent to have formed a partnership. In our opinion, this evidence is the type of evidence contemplated in Rule 462.200, subdivision (b)(2), and, thus, while each piece of evidence, individually, may not suffice, if the Assessor is satisfied that the evidence, taken together, provides clear and convincing evidence that B and S's intent was to form a partnership, the Assessor should find that each parcel of property for which there is evidence demonstrating that it is part of the partnership was beneficially owned by the partnership.

Issue 2 – Change in Ownership of Property Held by the Partnership

Section 60 provides that a change in ownership is "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." Thus, generally, transfers of interests in legal entities that own real property do not constitute transfers of the real property owned by the legal entity. (Rev. & Tax. Code, § 64, subd. (a).) However, a transfer of legal entity interests that results in a change in control of the legal entity results in a change in ownership of all of the property owned by the legal entity. Section 64, subdivision (c)(1) 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.

Rule 462.180, subdivision (d)(1), defines "control" for change in control purposes under section 64, subdivision (c). That rule states that a person or legal entity has obtained "control" of a partnership when that person or legal entity has obtained more than a 50 percent interest in partnership capital *and* more than 50 percent of the total interest in partnership profits.

Section 64, subdivision (c)(2) excludes from change in ownership certain transfers of minority partnership interests to a majority owner who becomes the sole owner of the partnership. It provides that:

> On or after January 1, 1996, when an owner of a majority ownership interest in any partnership obtains all of the remaining ownership interests in that partnership or otherwise becomes the sole partner, the purchase or transfer of the minority interests, subject to the appropriate application of the step-transaction doctrine, shall not be a change in ownership of the real property owned by the partnership.

Subdivision (c)(2) of section 64 was enacted by Statutes 1995, chapter 497, section 40 to codify Board staff's long-standing interpretation that transfers of minority interests to the majority partner were excluded from change in ownership under section 64, subdivision (a). The premise was that since the majority partner owns a controlling interest for property tax purposes, he already owned and controlled the legal entity that holds the property. Thus, for purposes of section 64, subdivision (c)(2), "majority ownership interest" is synonymous with "control" for change in control purposes under section 64, subdivision (c) and Rule 462.180, subdivision (d)(1).

In this case, if prior to B's death, S owned a 50.000037 percent interest in both profits and capital, S would have had a majority ownership interest in the partnership, and the transfer of B's partnership interest to S would qualify for the section 64, subdivision (c)(2) exclusion from change in ownership. However, if, prior to B's death, S owned a 50.000037 percent interest in partnership capital but only a 50 percent profits interest in the partnership, the section 64, subdivision (c)(2) exclusion would not apply because, pursuant to the definition of "control" found in Property Tax Rule 462.180, subdivision (d)(1), which requires a greater than 50 percent interest in *both* partnership profits *and* capital, S would not have had control of the partnership for property tax purposes prior to B's death. Under that scenario, S would own 100 percent of both the profits and capital interests in the partnership after B's death, and the transfer would result in S obtaining control of the partnership under section 64, subdivision (c)(1).

You have provided partnership Schedule K-1s, spanning eight years, that show S owned a 50.000037 percent capital interest in the partnership but a 50 percent profits interest. You have also provided a declaration from the partnership's accountant (presumed to be accurate and complete) that S's correct ownership percentage in both the capital and profits was 50.000037, and that because the difference was so small, B and S shared the income equally. The accountant further states that this was an error in the allocation of the profits of the partnership and was not discovered until B's death and that the error is in the process of being corrected. S states, in her declaration, that her management of the day-to-day operations of the partnership and additional $50,000 dollars paid into the partnership account for her slight majority ownership interest in both the capital and profits of the partnership.

Generally, a party has the burden of proof as to the existence of a fact that he is asserting. (Evid. Code, § 500.) And if the existence of an essential fact is left in doubt by the party upon whom the burden rests to establish that fact, that party bears the consequence. (*California Shoppers, Inc. v. Royal Globe Insurance* (1985) 175 Cal.App.3d 1.) You stated, in your June 26,

2006 letter to Robert Lambert, with respect to S's capital (50.0000370 percent) and B's capital (49.9999630 percent) interests shown on the provided Schedule K-1s, that, "These documents are inherently reliable as they were contemporaneously prepared without property tax consequences in mind." We are in agreement. And for that same reason, we believe that those documents are reliable as to S's profit (50 percent) and B's profit (50 percent) interests shown. It has been our position in the past that when evaluating evidence presented, documents, such as affidavits, prepared after the fact are generally given less weight than contemporaneous documents prepared at the time of the alleged event. (See May 4, 1993 Cazadd letter at p. 8, attached.)

However, as the finder of fact, Rule 462.200, subdivision (b) requires the Assessor to take into account all the evidence presented by the taxpayer including declarations and cancelled checks, and the Assessor may rely upon such evidence produced to establish that an error was made in the reporting of the capital and profits interest on the partnership's Schedule K-1s. S's declaration stating that she managed the day-to-day operations of the partnership and her cancelled check could bolster such a conclusion since a slight majority in profits and capital interests of the partnership could have been granted to S in recognition of the fact that she would be more active in the partnership than B. Further, if the Assessor finds credible S's declaration that the $50,000 contribution to the partnership was made solely by her in payment of partnership debts, the Assessor should determine that S had a slight majority ownership interest in the partnership.

If, based on the foregoing evidence, the Assessor agrees that the presumption is rebutted under Rule 462.200, subdivision (b), i.e., that B and S formed a partnership and S's capital *and* profits interest in the partnership was 50.000037 percent, then the transfer of B's partnership interests to S would qualify for the section 64, subdivision (c)(2) exclusion and would not result in a change in ownership of the properties owned by the partnership.

The views expressed in this letter are only advisory in nature. They represent the analysis of the legal department based on present law and the facts set forth herein. Therefore, they are not binding on any person or public entity.

Sincerely,

Richard S. Moon
Senior Tax Counsel

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Enclosure [Annotation 220.0278 (C 5/14/93)]