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August 4, 1983

Partnership Incorporation

This is in reply to your letter of June 17, 1983, to Mr. Lawrence A. Augusta requesting an opinion as to whether any of your proposed methods of incorporating a partnership would be considered a change in ownership of real property presently owned by your client's partnership under the provisions of Revenue and Taxation Code Sections 60-68.

Proposed Transactions

1. The Partnership will contribute its assets (including the Property) to a newly organized corporation in exchange for the stock of the corporation. The stock of the corporation will then be distributed by the Partnership to the Partners in a liquidating distribution. The Partnership will dissolve, and the Partners will each have the same proportional ownership interest in the corporation as they had in the Partnership.

This alternative is in conformity with the exclusion provided by Revenue and Taxation Code Section 62(a) and California Administrative Code, Title 18, Rule 462(j)(2)(B) (copy enclosed).

2. The Partnership will first liquidate and distribute its assets, including the Property, to the Partners in accordance with their proportional Partnership interests. The Partners will then contribute their undivided interests in the assets, including the Property, to a new corporation in exchange for stock of the corporation. The Property will first be transferred to the Partners individually, then to the corporation.

The Partners will each have the same proportional ownership interest in the corporation and its assets as they did in the Partnership.

This proposal would qualify for an exclusion from change of ownership reappraisal. However, particular care must be exercised in the deeding of parcels to the various partners to insure that the proportional ownership interests do not vary in any manner.

3. The Partners will each contribute their Partnership interests to a new corporation in exchange for stock. The Partners will own the same proportional interests in the corporation and the corporation's assets as they did in the Partnership. After the transfer of the Partnership interests to the new corporation, the Partnership, having only one member (the corporation), will cease to exist. The Property will be transferred (by operation of law) from the Partnership to the corporation.

This method would qualify for an exclusion from change in ownership reappraisal.

4. The transaction will be the same as Alternative No. 3, but a few of the Limited Partners may dissent from the overall plan of incorporation and may elect not to transfer their Partnership interests to the new corporation. The Partnership, therefore, will remain in existence and then will consist of those few Partners who elected not to incorporate their Partnership interests (the "Unincorporated Partners") and the new corporation. The new corporation will own all the Partnership interests of those Partners who transferred their Partnership interests to the corporation in exchange for stock (the "Incorporated Partners") and the Incorporated Partners will own stock in the new corporation proportionate to the value of the Partnership interests they transferred. Because the Partnership remains in existence, the Property will not be transferred. The Unincorporated Partners will retain their original interest in the Partnership and its assets (including the Property). The Incorporated Partners will have the same proportional ownership interests in the assets of the Partnership (including the Property), but will not have the same <u>percentage</u> ownership in the new corporation as they did in the Partnership (because not all the Partners are incorporating their interests). For example, if 10 individual partners in an 11 partner partnership own 90% of the partnership interests (9% for each partner), and those 10 partners transfer their

partnership interests to a new corporation in exchange for 100% of the new corporation's stock, each of those individuals will own 10% of the stock of the new corporation, which, in turn, will then own 90% of the partnership interests. Each individual, therefore, will retain a 9% interest in the partnership's assets (i.e., 10% of 90%).

This procedure would cause a reappraisal of 100% of the partnership's real property. This result stems from Revenue and Taxation Code Section 64(c) and Rule 462(j)(4)(A)(i). In this circumstance, control of the partnership is transferred to a new entity and the partnership continues. Additionally, the proportional ownership interests could not be considered to have remained the same after the transfers.

I believe the above addresses the issues raised in your letter and if any further assistance may be provided, please do not hesitate to contact me.

Very truly yours,

Gilbert T. Gembacz
Tax Counsel

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