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E. L. SORENSEN, JR.  
Executive Director

November 19, 1999

Re: Application of Exceptions to Reassessment in Proposed Transfers of LLC Interests

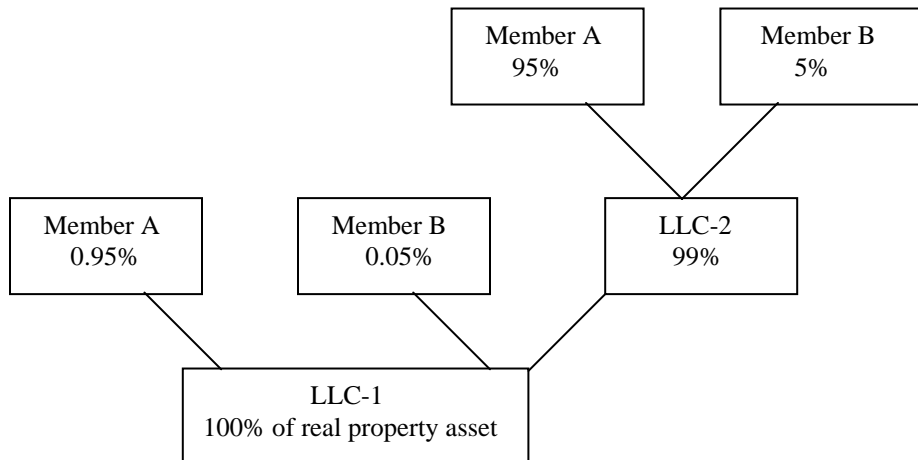
Dear Ms. :

Your letter to Larry Augusta, dated October 13, 1999, was assigned to me for response. You asked for an opinion as to whether the proposed transfer of certain LLC interests would result in a "change of ownership," triggering a reassessment of real property held by the LLC in which the LLC whose interests are transferred has the majority ownership interest, or whether there is an applicable exclusion from reassessment under the Revenue and Taxation Code. We consider the transfer of interests to be excluded from change in ownership and from change of control. (Rev. & Tax. Code sections 62, subdivision (a)(2), and 64, subdivision (a).)

After our phone conversation on October 25<sup>th</sup>, you faxed the enclosed diagram of the proposed transaction. An alternative transfer was also suggested, for which no fax was received. I will analyze each proposed transaction separately.

1. LLC-2 to LLC-1

The real property is owned by LLC-1 and is its only asset. LLC-1 has two individual members, A and B, and an entity member, LLC-2, which in turn is wholly owned by A and B. Interests are as follows:



A and B have the same proportional share of the 1% they own directly in LLC-1 as the share of the 99% they own indirectly in LLC-1 through LLC-2 -- A with 95% and B with 5%.

The proposed transaction would have LLC-2 transfer or distribute its 99% interest in LLC-1 to A and B in the same percentages as the percentages of A and B's pre-transfer interests in both entities – 95% to 5%. After the transfer or distribution, A will directly own 95% of LLC-1 and B will directly own 5% of LLC-1.

### Analysis

Section 62, subdivision (a)(2), excludes from change in ownership, transfers:

“...between...individuals and a legal entity...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.”

In recently amended Property Tax Rule 462.180, the Board has interpreted section 62, subdivision (a)(2), to apply to transfers of interests in entities as well as to transfers of real property. Excluded from change of ownership are proportional interest transfers like that proposed, in which the LLC-2 interests in LLC-1 are transferred to the individual members of LLC-2 in exactly the same proportion which they currently hold. See enclosed Rule 462.180 (d)(4).

Where the exclusion in section 62, subdivision (a)(2) applies to a transfer that would otherwise trigger a section 64, subdivision (c) change in control, the section 62, subdivision (a)(2) exclusion takes precedence because the transfers are proportional with the underlying ownership interests of the members or partners in the entity which owns the real property remaining the same. This conclusion, of course, depends upon the validity of our view that it is appropriate to “look through” the entity, in this case, the LLC, to its members for purposes of applying section 62, subdivision (a)(2). We have consistently held this view since that provision was enacted. (See Annotation 220.0389, C 7/31/95, copy enclosed.)

There is another reason why A and B's acquisition of the interests in LLC-1 resulting from the transfer would not cause a “change in control” under section 64, subdivision (c). If A or B can be said to have “obtain[ed] control through direct or indirect ownership or control of ...a majority ownership interest in any ...limited liability company...through the purchase or transfer of... limited liability company interest,...the purchase or transfer of that... interest shall be a change in ownership of the real property owned by the ...limited liability company...in which the controlling interest is obtained.” As you noted in your letter, however, A can not be said to have “obtained” control, as he already possessed effective control of LLC-1 before the transfer through his combined direct (0.95%) and indirect (95% of LLC-2's 99% = 94.05%) interests.

Accordingly, there would be no reassessment of the real property owned by LLC-1 occasioned by the proportional transfer of LLC-2 interests in LLC-1 to A and B.

2. **LLC-2 to LLC-3**

You posit as an alternative proposal a transfer of LLC-2's 99% interest in LLC-1 to a new entity, LLC-3, in which A and B would be the only members, retaining their same proportional interests in the new LLC-3.

The same analysis applies: the proportional transfer of LLC-2's interests to LLC-3 would be excluded from "change in ownership" under section 62, subdivision (a)(2), and the transfer of LLC-2's interests to LLC-3 would not lead to a disqualifying change in control under section 64, subdivision (c) because the underlying membership interests of A and B would be the same.

However, in the case of the transfer to LLC-3, you should note that A and B would be considered "original coowners" under section 64, subdivision (d), so that "[w]henver 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..." (Emphasis added.)

The views expressed in this opinion are, of course, advisory only. 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,

*/s/ Susan Scott*

Susan Scott  
Tax Counsel

SAS:jd

<h:/property/precednt/lc/1999/02sas>

Enclosures

cc:

Mr. Richard Johnson – MIC:63  
Mr. David Gau – MIC:64  
Mr. Charles Knudsen – MIC:64  
Ms. Jennifer Willis – MIC:70  
Mr. Lawrence A. Augusta