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450 N STREET, SACRAMENTO, CALIFORNIA  
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0082  
TELEPHONE 714-796-1667 • FAX 916-323-3387  
[www.boe.ca.gov](http://www.boe.ca.gov)

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July 23, 2008

**Re: Change in Ownership – Section 62, subdivision (a)(2) Exclusion  
Assignment No.: 07-419**

Dear Mr. \_\_\_\_\_ :

This is in response to your fax to Tax Counsel IV Sophia Chung requesting our opinion as to whether certain transfers of real property interests to and from legal entities owned by several trusts caused a change in ownership of any of the real property interests transferred. For the reasons explained below, it is our opinion that the transactions did not result in a change in ownership of any of the real property interests transferred.

**Factual Background<sup>1</sup>**

On November 1, 2006, M \_\_\_\_\_, LLC (Original LLC) owned various parcels of real property (the Parcels).<sup>2</sup> The Original LLC was owned by five trusts – D \_\_\_\_\_ B \_\_\_\_\_ Living Trust (DB Trust), C \_\_\_\_\_ B \_\_\_\_\_ Living Trust (CB Trust), M \_\_\_\_\_ & T \_\_\_\_\_ Family Trust (MT Trust), A \_\_\_\_\_ M \_\_\_\_\_ N \_\_\_\_\_ Trust No. 1 (AMN Trust), and D \_\_\_\_\_ V \_\_\_\_\_ N \_\_\_\_\_ Trust No. 1 (DVN Trust). All five trusts are revocable trusts. D \_\_\_\_\_ B \_\_\_\_\_ is the Trustor of the DB and CB Living Trusts. M \_\_\_\_\_ N \_\_\_\_\_ is the Trustor of the MT, AMN, and DVN Trusts.

**Step 1.** Original LLC deeded a 45 percent undivided interest in the parcels to DB Trust and a 5 percent undivided interest in the parcels to CB Trust, in exchange for the trusts' membership interests in Original LLC. As a result DB Trust and CB Trust were no longer members of Original LLC, and D \_\_\_\_\_ B \_\_\_\_\_, through the DB and CB Trusts, owned a direct 50 percent interest in the Parcels. As a result of the withdrawal of DB Trust and CB Trust as

<sup>1</sup> The facts are taken from a December 19, 2006 letter from \_\_\_\_\_ to the \_\_\_\_\_ County Assessor's office and a July 3, 2008 conversation with D \_\_\_\_\_ B \_\_\_\_\_ and his representative, \_\_\_\_\_. If the facts are not as set forth in this opinion, of course, our opinion may be different.

<sup>2</sup> For purposes of this opinion, we assume that the parcels were purchased by Original LLC and were not transferred to the LLC in a transaction excluded from change in ownership under section 62, subdivision (a)(2).

members of Original LLC, MT Trust, AMN Trust, and DVN Trust became 80 percent, 10 percent and 10 percent owners respectively of Original LLC.

**Step 2.** DB Trust and CB Trust formed a new limited liability company (LLC), Marketplace Village, LLC (the New LLC) and transferred a 45 percent interest in the Parcels and a 5 percent interest in the Parcels respectively, in exchange for a 90 percent membership interest in New LLC and a 10 interest in New LLC respectively.

### Legal Analysis

Revenue and Taxation Code<sup>3</sup> 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. Because trusts are not treated as separate legal entities for property tax purposes<sup>4</sup> (i.e., we "look through" the trust), the present beneficiary of an irrevocable trust is regarded as the owner of the property held in trust, while the Trustor is considered the present beneficiary of a revocable Trust. (See Property Tax Annotation 220.0761.) Further, subdivision (b)(1)(C) of Property Tax Rule<sup>5</sup> 462.160, which interprets and explains the statutory provisions related to trusts, provides that a change in ownership does not include:

The transfer of an ownership interest in a legal entity holding an interest in real property by the trustor into a trust in which the trustor-transferor is the sole present beneficiary or to a trust in which the trustor-transferor retains the reversion as defined in subdivision (b)(1)(B) of this rule. However, a change in ownership of the real property held by the legal entity does occur if Revenue and Taxation Code section 61(i), 64(c) or 64(d) applies because the change in ownership laws governing interests in legal entities are applicable regardless of whether such interests are held by a trust.

In your case, since D B is the Trustor of the DB and CB Living Trusts, for property tax purposes, he is regarded as the beneficial owner of the assets of those trusts for property tax purposes. (See Property Tax Rule 462.160.) Similarly, since M N is the Trustor of the MT, AMN, and DVN Trusts, for property tax purposes, he is regarded as the beneficial owner of the assets of those trusts. (*Id.*) Thus, prior to any transfers, D B, through the DB and CB Living Trusts, was the owner of 50 percent of Original LLC and indirectly 50 percent of the Parcels, and M N was the owner of 50 percent of Original LLC and indirectly 50 percent of the Parcels.<sup>6</sup>

Changes in ownership include, but are not limited to "[t]he transfer of any interest in real property between a corporation, partnership, or other legal entity and a shareholder, partner, or any other person." (Rev. & Tax. Code, § 61, subd. (j).) Thus, a transfer of real property to or

<sup>3</sup> All statutory references are to the Revenue and Taxation Code unless stated otherwise.

<sup>4</sup> Massachusetts business trusts and similar entities are not considered "trusts." (Cal. Code Regs., tit. 18, § 462.160, subd. (e).)

<sup>5</sup> All references to Property Tax Rules or Rules are references to title 18 of the California Code of Regulations.

<sup>6</sup> Further references to ownership of the Parcels by D B assumes that that ownership is through the DB and CB Trusts. Similarly, all further references to ownership of the Parcels by M N assumes that that ownership is through the MT, AMN, and DVN Trusts.

from an LLC generally results in a change in ownership unless excluded by another provision of law.

Section 64, subdivision (a) generally provides that a transfer of ownership interests in a legal entity, such as a limited liability company, does not constitute a transfer of the real property held by the entity, and thus, does not constitute a change in ownership of the real property owned by the entity. Section 64, subdivision (c)(1) provides, however, 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 . . . 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. (Emphasis added.)

"Control" is further defined and applied to partnerships and limited liability companies specifically in Rule 462.180, subdivision (d)(1)(B), which states that a change in ownership occurs when a partnership, limited liability company or other legal entity:

obtains through multi-tiering, reorganization, or any transfer direct or indirect ownership of more than 50 percent of the total interest in partnership or LLC capital and more than 50 percent of the total interest in partnership or LLC profits  
. . . .

Section 62, subdivision (a)(2), however, excludes the following 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.

In order for a transfer of real property from an LLC to its individual members to be proportional, each member's percentage interest in the real property after the transfer must be identical to the percentage interest they each held in the LLC capital and profits before the transfer. (Property Tax Rule 462.180, subd. (b)(2).) The California Courts of Appeal have held that when real property is transferred to individual owners from a legal entity, that transfer is excluded from the definition of a change in ownership pursuant to section 62, subdivision (a)(2) *only* if the proportional interests of each owner in each piece of real property remains identical after the transfer. (Emphasis added.) (See *Kern v. Imperial County* (1990) 226 Cal.App.3d 391 and *Munkdale v. Giannini* (1995) 35 Cal.App.4th 1104.) However, section 64, subdivision (d) provides that when a transfer is excluded from change in ownership under section 62,

subdivision (a)(2), the persons or entities holding interests in the legal entity immediately after the transfer become "original co-owners." Subsequently, the transfer of cumulatively more than 50 percent of the ownership interests in the legal entity by the original co-owners causes a change in ownership of all of the real property previously excluded from change in ownership under section 62, subdivision (a)(2).

In your case, Original LLC transferred a 50 percent interest in the Parcels to D B through its deeding a 45 percent undivided interest in the Parcels to DB Trust and a 5 percent undivided interest in the Parcels to CB Trust, in exchange for the trusts' membership interests in Original LLC. This transfer is excluded from change in ownership pursuant to section 62, subdivision (a)(2) since D B 's indirect ownership interests in the Parcels before the transfers was the same as his direct ownership interest in the Parcels after the transfers. Specifically, prior to the transfer, D B owned a 50 percent indirect interest in the parcels through the DB Trust's and CB Trust's combined 50 percent ownership in Original LLC. After the transfers D B continued to own a 50 percent interest in the Parcels through the DB and CB Trusts direct combined ownership of a 50 percent interest in the Parcels. Further, M N 's ownership interest in the Parcels remained the same before and after the transfers. Specifically, before the transfers, M N owned a 50 percent indirect interest in the Parcels through the MT, AMN, and DVN Trusts' combined ownership of 50 percent of Original LLC, and after the transfer M N continued to own 50 percent of the Parcels indirectly through the MT, AMN, and DVN Trusts' ownership of 100 percent of Original LLC

However, as a result of the transfers and withdrawal of DB Trust and CB Trust as members of Original LLC, M N , through MT, AMN and DVN Trusts, became the owner of 100 percent of Original LLC, resulting in his obtaining a controlling interest in Original LLC under section 64, subdivision (c)(1). Since there was a change in control as a result of such transfers, the 50 percent of the Parcels owned directly by Original LLC would undergo a change in ownership absent an exclusion. (See Rev. & Tax. Code, § 64, subd. (c)(1); see also *Title Ins. & Trust Co. v. County of Riverside* (1989) 48 Cal.3d 84.) However, because the proportional ownership interests in the parcels remained the same before and after the transfers as described above, section 62, subdivision (a)(2) excludes such transfers from change in ownership. (See Annotation 220.0102.)

As a result of the section 62, subdivision (a)(2) exclusion, M N became an original co-owner under section 64, subdivision (d) and, thus, the subsequent transfer of cumulatively more than 50 percent of the ownership interests in Original LLC by M N will cause a change in ownership of all of the Parcels owned by Original LLC previously excluded from change in ownership under section 62, subdivision (a)(2).

In Step 2, DB Trust and CB Trust formed New LLC and transferred a 45 percent interest in the Parcels and a 5 percent interest in the Parcels respectively, in exchange for a 90 percent membership interest in New LLC and a 10 interest in New LLC respectively. This transfer is excluded from change in ownership pursuant to section 62, subdivision (a)(2) since D B 's direct ownership interests in the Parcels before the transfers was the same as his indirect ownership interest in the Parcels after the transfers. Specifically, prior to the transfer, D B owned a 50 percent direct interest in the parcels through the DB Trust's and CB Trust's combined 50 percent ownership in the Parcels, and after the transfer D B owned a 50 percent indirect interest in the Parcels through his 100 percent ownership of New LLC. Thus, as a result, D B

became the owner of 100 percent of New LLC, and indirectly maintained his 50 percent ownership interest in the Parcels.

Because the transfer of the Parcels to New LLC was excluded from change in ownership by section 62, subdivision (a)(2), D B became an original coowner in New LLC such that a subsequent transfer of more than 50 percent of the interests in New LLC will cause a change in ownership of the Parcels owned by New LLC previously excluded from change in ownership under section 62, subdivision (a)(2).

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 III (Specialist)

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cc:

Mr. David Gau	MIC:63
Mr. Dean Kinnee	MIC:64
Mr. Todd Gilman	MIC:70