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March 1, 2006

**Re: *Change in Ownership – Section 62(a)(2)***  
***Transfer of Real Properties to a Family Limited Partnership***

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

This is in response to your November 9, 2005 letter requesting a legal opinion that the proposed transfer of four separate groups of real properties to a California family limited partnership, each in exchange for a different class of partnership interests (Class A, Class B, Class C, and Class D), is excluded from change in ownership pursuant to Revenue and Taxation Code<sup>1</sup> section 62, subdivision (a)(2). As explained in detail below, we conclude that the transfer of the properties in exchange for Class A partnership interests is not excluded pursuant to section 62, subdivision (a)(2), but that the transfers of properties in exchange for Classes B, C and D partnership interests are excluded from change in ownership pursuant to section 62, subdivision (a)(2).

**Summary of Facts**

As detailed in your letter, the following summarizes the information that you provided regarding the proposed transfers:

*The Properties*

1. The FLP Properties

31 parcels of real property located in \_\_\_\_\_ County are owned by S \_\_\_\_\_, a California Family Limited Partnership (the FLP). The FLP is owned in the following percentages: 66 percent by the Z \_\_\_\_\_ Trust of 1978 (the 1978 Z Trust), 8 percent each by J \_\_\_\_\_, D \_\_\_\_\_, T \_\_\_\_\_ (Thomas Z) and R \_\_\_\_\_ (Rebecca Z) (collectively, the Z Children), and 2 percent owned by H B L \_\_\_\_\_, Inc. (HBL), a California S corporation, all stock of which is owned by the 1978 Z Trust.

<sup>1</sup> Unless otherwise specified, all further statutory references are to the Revenue and Taxation Code.

The 1978 Z Trust is a Revocable Inter Vivos Trust, with Stanley and Myrna Z (Stanley Z or Myrna Z, collectively the Z Parents) as trustors and trustees and the Z Children as the beneficiaries.

## 2. The Mortgage Mart Properties

39 parcels of real property are owned by M M , Inc., a California C corporation, which in turn is 100 percent owned by the 1978 Z Trust.

## 3. The Grandparents' Trust's Properties

An apartment complex located at , California, and other real property holdings are the grandparents' trust's properties. These properties are 100 percent owned by the Z Family Trust of 1981 (the 1981 Z Trust), which was established by the Z Children's grandparents prior to their death. While not stated in your letter, for purposes of this opinion, we assume that the 1981 Z Trust is an irrevocable trust. Stanley Z is the trustee, and the four Z Children are the sole beneficiaries, each as to an undivided 25 percent interest.

## 4. The N Property

An apartment complex located at N Avenue, , is 33 1/3 percent owned each by Stanley Z, Thomas Z and Rebecca Z , as tenants in common.

Prior to the proposed transfer, Stanley Z will convey his undivided one-third interest in equal shares (one-sixth each) to Thomas Z and Rebecca Z, as a transfer between parent and children. After that transfer, Rebecca Z and Thomas Z will each own an undivided 50 percent interest in the N property as tenants in common, which property will then be conveyed to the FLP.

### *Proposed Transactions*

The Z Parents and the Z Children contemplate consolidating their real estate holdings under the FLP umbrella. To that end, the FLP plans to have four classes of partnership interests and each class will represent a particular group of properties as follows:

Class A partnership interests will represent the FLP Properties;

Class B partnership interests will represent the M M Properties;

Class C partnership interests will represent the Grandparents' Trust's Properties; and

Class D partnership interests will represent the N Property.

You state that each class of FLP partnership interests will be exchanged for that partner's previous direct or indirect ownership interest in the specific properties represented by that class of interests. We assume that the result would be that following the transfers, each of the present owners, through their respective percentage interests in a class of FLP partnership interests, will

continue to retain exactly the same interests they held previously in that class of property, such that if the FLP were dissolved, the previous owners of the property would receive back exactly that percentage of the property that had been transferred to the FLP. While you did not provide partnership agreements or trust documents, we also assume, for purposes of this letter, that by “represents,” you mean that each percentage of partnership class will carry with it the same percentage of capital and profits in each piece of real property as prior to the transfer.

Finally, you state that Stanley Z will act as the sole general partner of the FLP but will neither be compensated for his services nor have any direct or indirect ownership interest in any of the four classes of partnership interests.

### **Legal Analysis**

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.” (Rev. & Tax. Code, § 60.) It includes, but is 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 a limited partnership generally results in a change in ownership unless excluded by another provision of law. Section 62, subdivision (a)(2) provides an exclusion for proportional ownership interest transfers. It states that:

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.

Where, as here, there is a transfer of property interests to a single limited partnership in exchange for a separate series of partnership interests in the limited partnership, the section 62, subdivision (a)(2) “proportional ownership interest” requirement is met if each partner will own the same percentage of capital and profits in each piece of real property through the class of partnership interests in the limited partnership as each member owned in its respective property prior to the transfer. (Property Tax Rule 462.180, subd. (b)(2); see also Property Tax Annotation 220.0382 and Property Tax Annotation 220.0385.)

Based upon the information that you have provided to us, as discussed below, we conclude that the transfer of the FLP Properties does not meet the requirements of section 62, subdivision (a)(2) as the interests in each and every piece of property do not remain the same before and after the transfer. However, the transfers of the Mortgage Mart Properties, the Grandparents’ Trust’s Properties, and the N Property, do meet the requirements of section 62, subdivision (a)(2).

#### **1. Class A Shares – Representing FLP Properties**

The FLP Properties are currently owned by the FLP which in turn is owned as follows: 66 percent by the 1978 Z Trust, 8 percent owned by each of the four Z Children, and 2 percent

by HBL, which is 100 percent owned by the FLP. The 1978 Z Trust is a revocable Inter Vivos Trust with the Z Parents as Trustees and the four Z children as beneficiaries. After the transfer, each Z Child will own 25 percent of Class A shares representing the FLP properties.

Because revocable living trusts are not treated as separate legal entities for property tax purposes, the trustor of a living trust is regarded as the owner of real property or legal entity interests held by the trust even when the trustor is not the present beneficiary of the trust. (Property Tax Rule 462.160, subd. (b)(2).) Thus, transfers between a living trust and a legal entity, or transfers of legal entity interest to or from a living trust, are excluded from a change in ownership as long as the trustor's beneficial ownership interests are the same before and after the transfer. (Property Tax Rule 462.160, subd. (b)(5); See Property Tax Annotation 220.0375.020.)

Thus, for change in ownership purposes, the Z parents, as trustors of the 1978 Z Trust, are considered the beneficial owners of the trust property. Since the 1978 Z Trust owns 68 percent of the FLP properties (66 percent outright plus 2 percent through HBL), the Z parents are considered to be 68 percent owners of the FLP properties prior to the transfer. Since after the transfer, each Z child will own 25 percent of the FLP properties, and the Z parents will own 0 percent, the transfer does not qualify for the section 62, subdivision (a)(2) exclusion as the transfer does not result solely in a change in the method of holding title to the real property in which proportional ownership interests of the transferors and transferees, in each and every piece of real property transferred, remain the same.

## 2. Class B Shares – Representing M M Properties

The M M Properties are owned by M M, a C corporation, which in turn is owned 100 percent by the 1978 Z Trust. Its ownership interest in the M M Properties will be exchanged for all of the Class B partnership interests in FLP. After the transfer, the 1978 Z Trust will own 100 percent of the Class B partnership interests representing the entire capital and profits interest in the M M Properties. Thus, the proportional ownership interests of the 1978 Z Trust in the M M Properties remain the same before and after the transfer.

Since the transfer results solely in a change in the method of holding title to the real property in which proportional ownership interests of the transferors and transferees, in each and every piece of real property transferred, remain the same, the transfer of the Mortgage Mart properties to the FLP in exchange for Class B partnership interests qualifies for the section 62, subdivision (a)(2) exclusion from change in ownership.

## 3. Class C Shares – Representing Grandparents' Trust's Properties

The Grandparents' Trust's Properties consists of an apartment complex located in as well as other real estate holdings. These properties are owned by the 1981 Z Trust, an irrevocable trust, with Stanley Z as the trustee and the four Z children as each 25 percent beneficiaries. The ownership interests in these properties will be transferred by the 1981 Z Trust to the FLP in exchange for Class C partnership interests. After the transfer, each Z child will receive 25 percent of Class C shares representing 25 percent of the capital and profits interest in the Grandparents' Trust's Properties.

Generally, a transfer of property into an irrevocable trust, including when a revocable trust becomes irrevocable, is a change in ownership unless the trustor is also the sole present beneficiary. (Rev. & Tax. Code, § 61, subd. (h); Property Tax Rule 462.160, subd. (b)(2).) Since the Z children are the only beneficiaries of the 1981 Z Trust, they are considered the present beneficial owners for change in ownership purposes. Thus, prior to the transfer, each Z child owns 25 percent of the Grandparents' Trust's Properties. After the transfer, each Z child will hold 25 percent of the Class C shares representing 25 percent of the capital and profits interest in the Grandparents' Trust's Properties.

Since the transfer results solely in a change in the method of holding title to the real property in which proportional ownership interests of the transferors and transferees, in each and every piece of real property transferred, remain the same, the transfer of the Grandparents' Trust's Properties to the FLP in exchange for Class C partnership interests qualifies for the section 62, subdivision (a)(2) exclusion from change in ownership.

4. Class D Shares – Representing N Property

The N Property is an apartment complex located at South N Avenue, . 33 1/3 percent is owned each by Stanley Z, Thomas Z and Rebecca Z, as tenants in common. Prior to the transfer to FLP, it is contemplated that Stanley Z will convey his 1/3 interest in equal shares (1/6 each) to Thomas Z and Rebecca Z in a transfer qualifying for the section 63.1 parent-child exclusion.<sup>2</sup> Thus, prior to the transfer to the FLP, Thomas Z and Rebecca Z will each own an undivided 50 percent interest in the N Property. Thomas Z and Rebecca Z will then transfer their interests in the property to the FLP in exchange for 50 percent of the Class D partnership interests representing 50 percent of the capital and profits interests in the N Property.

Thus, the transfer qualifies for the section 62, subdivision (a)(2) exclusion from change in ownership since the transfer results solely in a change in the method of holding title to the real property in which proportional ownership interests of the transferors and transferees, in each and every piece of real property transferred, remain the same.

It is also important to note that where the application of the section 62, subdivision (a)(2) exclusion occurs, the transferors who hold the ownership interests in the legal entity immediately after the transfer become "original coowners." Under the provisions of section 64, subdivision (d), if the "original coowners" should, in the future, transfer cumulatively more than 50 percent partnership interest in the FLP in one or more transactions, a change in ownership and a reappraisal of all the property previously excluded from reappraisal under section 62, subdivision (a)(2) will occur. (See Property Tax Annotation 220.0375.025.)

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<sup>2</sup> You did not provide details of this proposed transfer; however, we assume, for purposes of this letter, that the transfer would, in fact, qualify for the parent-child exclusion.

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

Sincerely,

A handwritten signature in black ink, appearing to read "Richard S. Moon". The signature is fluid and cursive, with a large initial "R" and "M".

Richard S. Moon  
Tax Counsel

Enclosures

RM:jh

Prec/prtnrshp/06/05-772.rm.doc

Prec/Prop.13-General/06/05-772.rm.doc

cc: Honorable

Mr. David Gau, MIC:63

Mr. Dean Kinnee, MIC:64

Ms. Mickie Stuckey, MIC:62

Mr. Todd Gilman, MIC:70