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March 15, 2012

Mr.

Re: *Non-Reassessment of Property on Subsequent Resale of Original Co-Owner Interest Assignment No.: 11-264*

Dear Mr. _____ :

This is in response to your letter dated October 10, 2011, to Acting Assistant Chief Counsel Christine Bisauta, wherein you requested our opinion regarding legal entity original co-owner interest transfers. As explained below, it is our opinion that once an "original co-owner" interest has been transferred, the transferee is not an original co-owner of that interest for purposes of future transfers of that interest when counting and cumulating interests under Revenue and Taxation Code ¹section 64, subdivision (d) (herein, Section 64(d)).

Factual Background

In 1978, individuals A and B purchased a parcel of improved property in Orange County taking title as tenants in common, each with a 50 percent interest in the property. A and B later formed the _____ Partnership (Partnership), a California general partnership, and contributed the property to the Partnership, each receiving in exchange a 50 percent capital and profits interest in the Partnership. A and B thus became "original co-owners" under Section 64(d). In 2005, B sold his entire 50 percent interest in the Partnership -- 25 percent each to individuals C and D. C now desires to purchase the partnership interests of D, so that the Partnership will then be owned 50 percent each by A and C.

You ask whether C's acquisition of D's interest would constitute the cumulative counting of over 50 percent of the Partnership interests held by original co-owners, causing a change in ownership under Section 64(d).

Law and Analysis

Article XIII A, section 2 of the California Constitution requires the reassessment of real property upon a "change in ownership," unless an exclusion from change in ownership applies. A change in ownership is defined in section 60 as "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."

¹ All section references are to the Revenue and Taxation Code unless otherwise indicated.

As a general rule, the transfer of any interest in real property to or from a legal entity is a change in ownership and results in reappraisal of the property transferred. (Rev. & Tax. Code, § 61, subd. (j); Property Tax Rule² (Rule) 462.180, subd. (a).) Section 62, subdivision (a)(2) (herein, Section 62(a)(2)) provides an exclusion from change in ownership for proportional ownership interest transfers of real property between a legal entity and an individual. To qualify for the exclusion, such transfers must result solely in a change in the method of holding title to the real property, and the proportional ownership interests of the transferors and transferees must remain exactly the same both before and after the transfer in each and every piece of real property transferred. (See also Rule 462.180, subd. (b)(2).)

Section 64, subdivision (a) provides the general rule that the transfer of ownership interests in a legal entity, such as corporate voting stock or partnership interests, does not constitute a transfer of the real property owned by the legal entity. One of the exceptions is under Section 64(d).

Section 64(d), as interpreted by Rule 462.180, subdivision (b)(2), provides that when a transfer of real property to a legal entity is excluded from change in ownership under Section 62(a)(2), each person holding an interest in that legal entity immediately after the excluded transfer becomes an "original co-owner" for purposes of determining the change in ownership consequences of any subsequent transfer(s) of that legal entity interest. "Original co-owner" status derives its source from the prior utilization of the exclusion for transfers into legal entities set forth in Section 62 (a)(2). (Property Tax Annotation (Annotation)³ 220.0452 (August 26, 1998).) Subsequently, whenever ownership interests representing cumulatively more than 50 percent of the total interests in the legal entity are transferred by any of the original co-owners in one or more transactions, a change in ownership occurs of that real property owned by the legal entity that was previously excluded from change in ownership under Section 62(a)(2).

However, certain transfers of original co-owner interests are not counted or cumulated for purposes of determining whether more than 50 percent of original co-owner interests have been transferred. For example, Rule 462.180, subdivision (d)(2) and Rule 462.220, subdivision (c) provide that transfers of original co-owner interests in legal entities between spouses that qualify for exclusion under section 63 are not counted and cumulated for purposes of Section 64(d). In addition, Rule 462.180, subdivision (d) provides that certain transfers to qualifying trusts excluded from change in ownership under section 62, subdivision (d), and proportional transfer ownership interests are not counted and cumulated. However, until an original co-owner interest is transferred *and* counted and cumulated for purposes of Section 64(d), the interest as held by the transferee is an original co-owner interest. Thus, if an original co-owner interest is transferred and excluded from counting and cumulating under Rule 462.180, subdivision (d)(2), the transferee takes the interest as an original co-owner.⁴

² Cal. Code Regs., tit. 18, § 462.180. All Rule references are sections to title 18 of the California Code of Regulations.

³ Property Tax Annotations are summaries of the conclusions reached in selected legal rulings of Board legal counsel published in the Board's Property Tax Law Guide and on the Board's website. See Cal. Code Regs., titl. 18, § 5700 for more information regarding annotations.

⁴ Notably, there is no exclusion from counting and cumulating for transfers between parents and children, or between original co-owners themselves. (See Rule 462.180, subd. (d)(2)).

We have regularly opined that when a transfer by an original co-owner to a third party is counted and cumulated for purposes of Section 64(d), the third party does not become an original co-owner with respect to those interests. The rule is that once an original co-owner interest is transferred *and* counted and cumulated, it is no longer an original co-owner interest. The reason is that the third party did not receive those interests in a transfer excluded from change in ownership under Section 62(a)(2), and Section 64(d) expressly states that one becomes an original co-owner by virtue of receiving legal entity ownership interests in a transaction excluded under Section 62(a)(2). Because the transferee is not an original co-owner with respect to those interests, a subsequent transfer of those interests by the recipient is not counted or cumulated for purposes of Section 64(d).

In this case, when B sold his partnership interests to C and D in 2005, because B was an original co-owner, the 50 percent had to be counted and cumulated for purposes of Section 64(d) because the transfer did not qualify to be excluded from counting and cumulating. Because B's 50 percent interest was transferred *and* counted and cumulated, C and D did not become original co-owners. As explained above, because C and D did not obtain their interests in a transaction excluded from change in ownership by Section 62(a)(2), they do not become original co-owners. Therefore, the subsequent sale of D's 25 percent interest to C is not counted for purposes of Section 64(d) and is thus considered a non-event for reassessment purposes. Thus, after the sale of B's entire partnership interest to C and D, only 50 percent of the original co-owner interests in the partnership are counted and cumulated for purposes of Section 64(d), and there is no change in ownership of the Partnership's previously excluded real property.

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,

/s/ Neha Duggal

Neha Duggal
Tax Counsel

ND:mcb

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cc: Honorable

County Assessor

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