STATE OF CALIFORNIA

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August 26, 1998

The Honorable John Tuteur
Napa County Assessor
1127 First St., Room 128
Napa, CA 94559-2931

In Re: **Change in Ownership - Inconsistency between Section 64(d) and Rule 462.180(d)(2), COS Filing Requirements.**

Dear Mr. Tuteur:

This is in response to your July 24, 1998 letter to Mr. Larry Augusta, in which you request our opinion regarding the proper interpretation of the language in Section 64(d) and in Rule 462.180(d)(2) applied to the change in ownership consequences of cumulated transfers by "original coowners" in a legal entity.

For purposes of our analysis, you have submitted the following transaction:

1. Three couples, A, B, and C, purchased certain property on May 15, 1967, and subsequently transferred their respective interests (33.33% in each couple) in that property to a partnership on June 29, 1982. Since their partnership interests were held in the same proportionate shares (33.33% in each couple) as their former co-ownership interests in the property, your office applied Section 62(a)(2) to exclude those transfers from change in ownership and reappraisal in 1982. Thus, couples A, B, and C were considered "original coowners" under Section 64(d) for purposes of determining a subsequent change in ownership when cumulatively more than 50% of the total partnership interests were transferred.

2. In 1984, couple A sold their cumulative partnership interest, 33.33% of the total interests in the partnership, to D. On October 13, 1989, couple B sold a portion of their cumulative partnership interest, equal to 17% of the total interests in the partnership, to E.

As the result of these two transfers, cumulatively 50.33% of the total interests in the partnership had been transferred, and the interests in the partnership were held as follows:

Couple B - 16.33%
Couple C - 33.33%
D - 33.33%
E - 17.00%

3. There is no evidence that a change in ownership statement was ever filed on the October 1989 transfer. Assuming that a change in ownership of the partnership property occurred at that time (pursuant to Section 64(d)), the requirements under Section 532(b) appear to mandate the enrollment of escape assessments back to that date.

Based on the foregoing your questions are:

(1) When the original coowners transferred cumulatively more than 50% of the partnership interests in October 1989, does Section 64(d) require reappraisal of 100% of the property or does the provision in Rule 462.180(d)(2) require reappraisal of only the percentage of the property equivalent to the cumulative partnership interests transferred, (e.g., 50.33%)?

(2) When property is reappraised because of the cumulative transfer by original coowners under Section 64(d), do the former "original coowners" lose that classification and become, in effect, new owners of a legal entity who did not use the Section 62(a)(2) exclusion, or do all of the partners become "original coowners" under the language of Rule 462.180(d)(2)?

(3) If no change in ownership statement was ever filed on the October 1989 transfer, and a change in ownership of the partnership property occurred at that time, does Section 532(b) require the enrollment of escape assessments back to that date?

As hereinafter explained, the answers to these questions are:

(1) Section 64(d) applies and 100% of the property is reappraised;
(2) The former partners lose their "original coowner" status after reappraisal; and
(3) Escape assessments must be enrolled to October 1989 change in ownership.

Question 1: When original coowners transferred cumulatively more than 50% of the partnership interests in October 1989, does Section 64(d) require reappraisal of 100% of the property or does Rule 462.180(d)(2) require reappraisal of only the percentage of the property equivalent to the cumulative partnership interests transferred, (e.g., 50.33%)?

Answer: Section 64(d) applies and 100% of the property is reappraised.

As stated in your letter, the Section 62(a)(2) exclusion applied to the June 1982 transfer of al property from couples A, B, and C to the partnership, since the partners, through their respective interests in the partnership, owned the same proportional percentage interests in the property following the transfer. However, by using the Section 62(a)(2) exclusion, couples A, B, and C became "original coowners" in the partnership.

Section 64(d) governs transfers of interests in legal entities made by "original coowners." Since the date of the Legislature's amendment of this section in Stats. 1982, Ch. 1465, effective January 1, 1983, the language in Section 64(d) has stated that whenever more than 50 percent of the total interests in the entity are transferred by the original co-owners, a change in ownership of all of the real property that was previously excluded from change in ownership under Section 62(a)(2) shall be reappraised.[1]

As originaliy adopted in 1979, the language in Section 64(d) provided, among other things, that the portion of the property which undergoes reappraisal in the event of a Section 64(d) change in ownership is only that percentage which is equivalent to the cumulative partnership (or legal entity) interests transferred. In Stats. 1982, Ch. 1465, the Legislature repealed most of the original language and replaced it with the current language which: (1) requires reappraisal of all of the property previously excluded under Section 62(a)(2), and (2) terminates the "original coowner" status of the transferors once change in ownership has occurred. Subsequent to the legislative change, the Board staff issued several Letters to Assessors (see LTA Nos. 83/20 and 83/39, attached) and opinion letters explaining the repeal nd amendments. Unfortunately, the original statutory language (adopted in 1979) was already included in Rule 462.180 (d)(2), (effective on June 10, 1982), prior to Stats. 1982, Ch. 1465. No further amendments or revisions were made to the rule (other than renumbering in 1994) following its 1982 effective date. As such, this language in subdivision (d)(2) of Rule 462.180 has long been inconsistent with Section 64(d) and should not be followed. The Board is currently in the process of updating and amending this rule, which includes the deletion of all language inconsistent with Section 64(d). (See proposed draft of Rule 462.180, attached.)

Question 2. When property is reappraised because of the cumulative transfer by original coowners under Section 64(d), do the former "original coowners" lose that classification and become, in effect, new owners of a legal entity who did not use the Section 62(a)(2) exclusion, or do all of the partners become "original coowners" under the language of Rule 462.180(d)(2)?

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[1] If property is transferred on or after March 1, 1975, to a legal entity in a transaction excluded from change in ownership by paragraph (2) of subdivision (a) of Section 62, then the persons holding ownership interests in that legal entity immediately after the transfer shall be considered the "original co-owners." Whenever 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 co-owners in one or more property transactions, a change in ownership of that real property owned by the legal entity shall have occurred, and the property that was previously excluded from change in ownership under the provisions of Section 62(a)(2) shall be reappraised. The date of reappraisal shall be the date of the transfer of the ownership interest representing individually or cumulatively more than 50 percent of the interests in the entity.

Answer: The former partners lose their "original coowner" status after reappraisal.

"Original coowner" status derives its source from one's prior utilization of the exclusion for transfers into legal entities set forth in Section 62(a)(2). As discussed above, the statutory scheme pertaining to "original co-owners" in Section 64 (d) was substantively altered by the Legislature in Stats. 1982, Ch. 1465. Thus, since January 1, 1983, "original co-owners," per Section 64 (d) are former transferors of property to the entity that avoided prior reassessment under Section 62(a)(2) because their proportional ownership interests in the entity remained identical to their previous ownership interests in the real property transferred. (See definition of "original co-owners" which is correct in Rule 462.180 under subdivision (b)(2). [2])

The sole intent then, is to track ownership interests in a partnership (or other legal entity) which acquired real property through an excluded Section 62(a)(2) transfer. Thus, the language of Section 64 (d) must be interpreted as referring to transfers exceeding 50% of the total interests in the entity, i.e., more than 50% of the total interests in the entity initially acquired by the group of original transferors, because it is only shifts in the interests of this group of owners in that entity which are relevant. (See SBE Special Topics Survey: Assessments Practices, p.15 (August 1984).) This scheme manifests the purpose of the "original co-owners'" exception in Section 64 (d) to prevent evasion from change in ownership and reappraisal through the use of legal entities and to maintain relative property tax parity between residential properties and business properties. Thus, the Legislature allowed ownership interests in real property to be transferred from individuals or legal entities to a legal entity and vice versa in the same proportionate shares with an exclusion from change in ownership under Section 62 (a)(2). However, the Legislature wanted to head off two-step transfers of property from one person to another person through a legal entity which would otherwise escape reappraisal, (e.g., "A" forms a corporation, transfers his home to the legal entity, sells his shares in the entity to "B", then "B" dissolves the legal entity). (See Report of Legislative Task Force on Property Tax Administration, Assembly Revenue and Taxation Committee, January 22, 1979, p.414.)[3]

Unfortunately, the language in the last paragraph of Rule 462.180(d)(2) is out of date and inconsistent with the statutory amendment to Section 64(d) for the same reasons stated above and should not be followed for any purpose. The correct statutory application is to identify as "original co-owners" only those who previously benefited from the Section 62, (a)(2) exclusion, and to count cumulative transfers of their interests in the partnership for purposes of determining a change in ownership under Section 64(d). Once a Section 64(d) change in ownership occurs, as

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[2] Rule 462.180(b)(2) states in pertinent part:
...The holders of the ownership interests in the transferee legal entity, whether such interests are represented by stock, partnership shares, or other types of ownership interests, shall be defined as "original co-owners" for purposes of determining whether a change in ownership has occurred upon the subsequent transfer(s) of the ownership interests in the legal entity.

[3] As the court stated in Sav-on Drugs, Inc. v. Orange County, 190 Cal.App.3d 1611, 1624-1625 (1987), "If the Legislature had not clarified the phrase 'change of ownership' as it did, corporations might have enjoyed an unjustifiable and unintended advantage over individuals in the buying and selling of real estate. Plaintiffs' real complaint is that they have not received special treatment. They have only been treated equally and must, like individuals who acquire control of real estate, undergo a reassessment...".

in the instant case where more than 50% of the total partnership interests are transferred by final coowners couple A and couple B, then couple B's and couple C's classification or status as "original coowners" is removed,[4] and their future transfers would not be counted for Section 64(d) purposes. Further, any new partners, i.e., the transferees D and E who acquired couple A's and couple B's partnership interests, would not be classified as "original coowners," because they did not utilize the Section 62(a)(2) exclusion. (The relevant exclusion applicable to D and E is Section 64(a), since they each acquired less than a 50% interest in the partnership.)

Question 3. If no change in ownership statement was ever filed on the October 1989 transfer, and a change in ownership of the partnership property occurred at that time, does Section 532(b) require the enrollment of escape assessments back to that date?

Answer: Yes. Escape assessments must be enrolled back to the October 1989 change in ownership.

The language of Sections 480 and 482 is very clear that sections 480, 480.1 and 480.2 apply to all changes in ownership subject to their terms and require statements to be filed for all such changes in ownership "occurring on or after March 1, 1975..." . In regard to legal entity transfers, Section 480.2 provides that "whenever there is a change in ownership of any corporation, partnership, limited liability company, or other legal entity, as defined in subdivision (d) of Section 64, a signed change in ownership statement as provided in subdivision (b) shall be filed by such corporation, partnership, limited liability company, or other legal entity with the board at its office in Sacramento. Since a change in ownership under Section 64(d) occurred on October 13, 1989, when couple B transferred 17% of the partnership interests to E, a change in ownership statement as required by Section 480.2 should have been filed by the partnership at that time.

The consequences of failing to timely file a change in ownership statement are three-fold. The first is that Section 482.1 authorizes the imposition of the penalty described in Section 482, in the amount of either $100 or 10 percent of the taxes applicable to the new base year value reflecting the change in ownership, whichever is greater, but not to exceed $2,500.

The second is that until the change in ownership statement is filed, the assessor's time limits for making escape assessments do not commence under Section 532 (b). This statutory provision (enacted by Stats. 1994, Ch. 544, which became effective on January 1, 1995), delays the commencement of the statute of limitations period for all escape assessments that occur prior to the time the statement is filed. After the statement is filed, however, there is no further delay, and the limitations period in subdivision (a) of Section 532 applies. This provision does not limit the number of escape assessment that can be made, but sets the time period in which they must be enrolled. (See Letter to Assessors No. 95/35, specifically page 5, attached.)

The third consequence is that escape assessments made as the result of a person's failure to file a change in ownership statement are subject to the 25% penalty assessment imposed under

[4] Couple A, of course, would no longer have any partnership interest.

Section 504 and the 9 percent interest charge authorized by Section 506. As set forth in Section 1.2, the penalty provisions of Article 3 commencing with Section 501 apply to any "real property which escaped assessment " (including property which has since been transferred to a bona fide purchaser or become subject to a lien) as a result of an unrecorded change in ownership," for which a statement required by Section 480.2 was not filed. As further set forth in Sections 532 and 75.11(d), the 25% penalty in Section 504 shall be added in the case where real property has escaped taxation or has been underassessed following an unreported change in ownership. (See Ochsner Letter 2/6/95, and LTA No. 95/35, page 3, attached.) In addition, interest as provided in Section 506 at the rate of three-fourths of 1 percent per month (9 percent annual) must also be added.

Once the required change in ownership statement is filed for the October 1989 transfer which resulted in the change in ownership of the partnership real property under Section 64(d), the assessor is required to reappraise all of the property previously excluded under Section 62(a)(2) and to levy escape and supplemental assessments as may be appropriate. (See Letters To Assessors Nos. 95/35 and 96/52, attached.)

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

Sincerely,

Kristine Cazadd
Senior Tax Counsel

KEC:ba
Attachments: Letters to Assessors Nos. 83/20, 83/112, 95/35, and 96/52.

cc: Mr. Richard Johnson
Mr. Rudy Bischof
Ms. Jennifer Willis
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