STATE OF CALIFORNIA

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I am writing in response to your letter dated February 7, 1990, wherein you request our opinion on the change in ownership consequences of two hypothetical transactions. The two hypothetical transactions are described and analyzed separately below:

Hypothetical No. 1

Facts

1. Partnership owns real property.

2. Partnership, in turn, is owned 60% by corporation A (parent corporation), 25% by corporation B (subsidiary corporation) and 15% by various individuals.

3. Corporation B is a wholly owned subsidiary of parent corporation A.

4. Parent corporation A proposes to transfer all of its interest in the partnership to subsidiary corporation B, which will then own 85% of the partnership.

Law and Analysis

All code references are to the Revenue and Taxation Code unless otherwise expressly stated.

When a corporation, or other legal entity or person, obtains a majority ownership interest in a partnership through the acquisition of partnership interest, the acquisition shall constitute a change of ownership of property owned by the partnership. (Section 64(c). See also Rule 462(j)(4)(A) of the Property Tax Rules of Title 18 of the California Code of Regulations.)

However, an exception exists if the transaction qualifies as a "corporate reorganization, where all of the corporations involved are members of an affiliated group, and which qualifies as a reorganization under Section 368 of the United States Internal Revenue Code and which is accepted as a nontaxable event by similar California statutes...." (section 64(b).)

Since corporation A proposes to transfer its interest in the partnership to corporation B, the portion of section 64(b) which refers to "any transfer of real property among members of an affiliated group" is inapplicable.

In this case, 100% of the stock of corporation B is owned by corporation A, so A and B are members of an affiliated group for purposes of section 64(b). However, you have not indicated whether or not the hypothetical transaction will qualify as a tax-free reorganization under I.R.C., section 368 and similar state statutes. If the proposed transaction will qualify as a tax-free reorganization, it will be excluded from change in ownership consequences under section 64(b).

If the proposed transaction will not so qualify, however, it still may be exempt from reappraisal if the requirements of section 62(a)(2) are satisfied. Pursuant to section 62(a)(2), change in ownership does not include:

> 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, which 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. The provisions of this paragraph shall not apply to transfers also excluded from change in ownership under the provisions of subdivision (b) of Section 64.

In this case, since corporation B is the wholly-owned subsidiary of corporation A, the proposed transfer of partnership interest from A to B will merely effect a change in A's method of holding title to its partnership interest, with proportional beneficial ownership interests in both the partnership and the underlying real property effectively remaining the same after the transfer. Therefore, if the

proposed transfer does not qualify for exclusion from change in ownership consequences under section 64(b), it should nevertheless qualify for exclusion under section 62(a)(2).1/

Hypothetical No. 2

Facts

1. A property is subject to a 50-year lease, with 35 years remaining.

2. Corporation A is the owner of the property and the lessor.

3. Corporation B is the lessee.

4. Corporation B is the wholly-owned subsidiary of corporation A.

5. The parties propose to (1) terminate the lease and (2) transfer the leasehold back to the lessor.

Law and Analysis

Your hypothetical transaction will result not only in the transfer of a leasehold interest with a remaining term of 35 years, but also in the termination of a lease with an original term in excess of 35 years. The termination will occur either through the express agreement of the parties or as a consequence of the merger of the lessor's and lessee's interests in the leasehold. Therefore, a change in ownership will result under section 61(c)(1) both on account of the lease transfer and lease termination unless an exclusion is found to be applicable.

Section 64(b) provides that "any transfer of real property among members of an affiliated group...shall not be a change of ownership." The definition of real property includes the possession of or right to possession of land and improvements. (Sections 104 and 105.) Therefore, real property leases are considered real property for purposes of section 64(b). Further, since corporation B is the wholly-owned subsidiary of corporation A, the two corporations are members of an affiliated group within the meaning of section 64(b).

1/ The provisions of section 62(a)(2) do not apply to transfers also excluded from change in ownership under section 64(b). (Section 62(a)(2).)

Therefore, section 64(b) would appear to apply to the leasehold transfer. Since corporation B is proposing to transfer the leasehold to its affiliate, corporation A, the transfer will be excluded from change in ownership consequences.

However, it is not clear that section 64(b) would also apply to the resulting lease termination. The legislature treated lease transfers and lease terminations separately and distinctly in section 61(c)(1). It is, therefore, not certain that the exclusion for real property transfers between affiliates set forth in section 64(b) is applicable to a lease termination which results from a lease transfer between affiliates.

Based upon the express language of section 61(c)(1), an argument can be made that the legislature intended that all terminations of leases with original terms of 35 years or more are to result in change in ownership of the demised property, regardless of whether or not an exclusion might otherwise apply.

In any event, it is preferable to be presented with the circumstances of an actual transaction prior to reaching a conclusion in a close case. Therefore, for the time being, we will defer our opinion on the possible application of the section 64(b) exclusion to lease terminations resulting from transfers of the lessee's leasehold interest.

The views expressed in this letter are, of course, advisory only and are not binding upon the assessor of any county.

Yours very truly,

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cc: Mr. John Hagerty
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