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May 9, 2012

Re: Change in Ownership – Partnership Distribution of Real Property Based on Special Allocation
Assignment No.: 11-295

Dear Ms. :

This is in response to your letter requesting our opinion regarding the proposed transfer of property owned by a partnership to one of the partners. As explained below, it is our opinion that such a transfer would result in a change in ownership of the property.

Facts

In July 1993, your client (Taxpayer) contributed $1 million to a partnership (the Partnership) in which Taxpayer was a partner. You have not indicated to us the percentage of capital and profits Taxpayer has in the Partnership. In September 1993, the Partnership purchased real property (Property A) with the funds contributed by Taxpayer, and took fee title to Property A in the Partnership's name. In connection with the purchase, the partners entered into a written agreement (the Option Agreement) whereby Taxpayer was given the option to purchase Property A for a purchase price equivalent to the original purchase price. Since the purchase of Property A, the Partnership has maintained a separate accounting of Property A and charged Taxpayer's special account with any costs or expenses related to Property A. Since then, Taxpayer has used Property A as Taxpayer's personal residence. The parties propose to have the Partnership transfer Property A to Taxpayer so that fee title will be in the name of Taxpayer.

You have provided to us a copy of the Option Agreement. In addition, you have provided us a copy of the Partnership Agreement. Both agreements are heavily redacted, so we are unable to determine with specificity some of the facts.

Law & 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 Revenue and Taxation Code[1] 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] Unless otherwise indicated, all "section" references herein are to the Revenue and Taxation Code.

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 interest transferred. (Rev. & Tax. Code, § 61, subd. (j).) Section 62, subdivision (a)(2) provides an exclusion from change in ownership under section 61, subdivision (j), 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 in each and every piece of real property transferred must remain exactly the same both before and after the transfer. (Rev. & Tax. Code, § 62, subd. (a)(2); Property Tax Rule[2] 462.180, subd. (b)(2).)

In this case, Property A is owned by the Partnership, which has several partners. It is our understanding that the other partners are Taxpayer's siblings. For the purposes of determining proportionality for change in ownership purposes, the percentage of capital and profits each partner has in the Partnership is measured against the respective percentages of fee title each would own as a tenant in common in Property A if the Partnership were to transfer Property out to its partners. Since Taxpayer does not own 100 percent of the Partnership capital and profits, a transfer of the property solely to Taxpayer would not be proportionate under section 62, subdivision (a)(2) and would result in a reassessment under section 61, subdivision (j).

The fact that the Partnership maintained a separate account for Property A does not affect this analysis. While we have opined that a legal entity may create separate classes of interests with respect to specific pieces of property in order to maintain proportionality, it appears that has not been done in this case. (See Property Tax Annotation[3] 220.0375.025 (3/29/02).) There is no reference to separate classes of partnership interests in the Partnership Agreement. On the contrary, section 1.05 of the Partnership Agreement states that "All property owned by the Partnership, whether real or personal, tangible or intangible, or mixed, shall be deemed to be owned by the Partnership as an entity, and no partner, individually or otherwise, shall have any ownership in such property." As such, for the purposes of section 62, subdivision (a)(2), all property owned by the Partnership is considered owned by the partners in the same proportion as their interests in capital and profit.

Your letter also states that the parties intended for the Partnership to hold Property A as nominee for Taxpayer. In support of this contention, you cite the following facts: Taxpayer has the option to purchase Property A for a purchase price equivalent to the original purchase price; Taxpayer has paid all utility costs, real property taxes, insurance and other expense relating to Property A; Taxpayer has always used Property A as Taxpayer's personal residence; and no other individual has had the beneficial use of Property A. We find no merit in this argument.

Transfers for the purpose of perfecting title, including transfers from a nominee holding bare legal title to the property's true beneficial owner, are excluded from change in ownership. (Rev. & Tax. Code, § 62, subd. (b); Rule 462.240, subd. (a)(1); *Parkmerced Co. v. City and County of San Francisco* (1983) 149 Cal.App.3d 1091.) In other words, where the beneficial use of a property remains in the existing assessee and the transfer of title is not coupled with a transfer of the right to immediate use, occupancy, possession or profits, the transfer is considered

[2] All "Rule" references are to sections of 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., tit. 18, § 5700 for more information regarding annotations.

to be the transfer of mere legal title to the property in order to formalize or perfect title of such existing assessee and does not result in any change in ownership.

Property acquired by a partnership is property of the partnership and not of the partners individually. (Corp. Code, §16203). In addition, Evidence Code section 662 provides that "[t]he owner of the legal title to property is presumed to be the owner of the full beneficial title" and that, "this presumption may be rebutted only by clear and convincing proof." Because the Partnership took fee title to Property A in its own name upon purchase, under these statutes the Partnership is presumed to be the full beneficial owner of Property A, and Property A is not the property of Taxpayer or any other partner. In order to show that the Partnership held legal title only as nominee for Taxpayer, the Evidence Code section 662 presumption must be rebutted by clear and convincing proof. The courts define clear and convincing proof as evidence "so clear as to leave no substantial doubt in the mind of the trier of fact," and as evidence "sufficiently strong to command the unhesitating assent of every reasonable mind." (*Tannehill v. Finch* (1986) 188 Cal.App.3d 224, 228; *Lillian F. v. Superior Court* (1984) 160 Cal.App.3d 314, 320; *Sheehan v. Sullivan* (1899) 126 Cal. 189, 193.)

For property tax purposes, Rule 462.200, subdivision (b)(2) sets forth the following types of documentary proof that may constitute clear and convincing evidence sufficient to rebut the deed presumption:

> (1) The existence of a written document executed prior to or at the time of the conveyance in which all parties agree that one or more of the parties do not have equitable ownership interests.
>
> (2) The monetary contribution of each party. The best evidence of the existence of any factor shall be an adjudication of the existence of the factor reflected in a final judicial finding, order, or judgment. Proof may also be made by declarations under penalty of perjury (or affidavits) accompanied by such written evidence as may reasonably be available, such as written agreements, canceled checks, insurance policies, and tax returns.

In our view, Taxpayer's $1 million "monetary contribution" was to the Partnership itself, not to the seller of Property A, and thus was a capital contribution to the Partnership and not a purchase of Property A by Taxpayer. Thus, any argument that Taxpayer was the true buyer of the property, although title was taken in the name of the Partnership as "nominee" for Taxpayer fails.

In our opinion, the best evidence of the parties' intention is reflected in the written Option Agreement entered into contemporaneously with the purchase of Property A by the Partnership. The Option Agreement states that "the purpose behind the purchase was to have a piece of residential property that could be used by the owners of the [] Partnership and the agent for the Partnership …." Thus, the Option Agreement does not limit the use of Property A to Taxpayer, but rather states that the *owners* of the Partnership as well as the agent[4] of the Partnership may use Property A. Further, paragraph 2 of the Agreement states that the agent of the Partnership shall have the "advantage of the utilization of Property A" and agrees to pay for the renovation of Property A as well as any furnishings required. You provided an affidavit from the agent stating

[4] In a subsequent phone conversation, you indicated that the agent was Taxpayer's father. This fact has no effect on our analysis.

that he or she did not pay for any expenses relating to Property A and did not utilize Property A and that, in fact, Taxpayer paid all expenses and used Property A as his or her principal residence. While this may be the case, at the time of the Partnership's purchase of Property A, there was not in existence an executed written document in which all partners agreed that the Partnership and none of the partners other than Taxpayer had any equitable ownership interests in Property A, as Rule 462.200, subdivision (b)(2) requires. Statements made after the fact about actual usage do not change the written agreement entered into at the time the Partnership purchased the property.

Moreover, the fact that the Partnership granted Taxpayer an option to purchase Property A is strong evidence that Taxpayer was not the true beneficial owner of the property. This is because the option would require Taxpayer to pay a purchase price to acquire Property A from the Partnership equal to the purchase price the Partnership paid upon its acquisition in July 1993. Clearly, if Taxpayer were already the true beneficial owner of Property A, and the Partnership were simply holding title as nominee for Taxpayer, no price for the purchase of the property by Taxpayer should be required since he would already be the beneficial owner of the property.

Based on the foregoing, in our opinion the Option Agreement did not have the effect of making the Partnership's purchase of Property A an acquisition of bare legal title in the name of the Partnership as nominee for Taxpayer. Rather, based on the plain language of both the Option Agreement and the Partnership Agreement, it is our opinion that the Partnership is and always has been the full beneficial owner of Property A. Consequently, a transfer to Taxpayer would result in a reassessment pursuant to section 61, subdivision (j).

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/ Daniel Paul

Daniel Paul
Tax Counsel

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cc: Honorable
President, California Assessors' Association
County Assessor

Mr. David Gau MIC:63
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