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November 21, 2012

**Re: *Rescission of Legal Entity Interest Transfers
Assignment No. 12-160***

Dear Mr. :

This is in response to your request for a legal opinion as to whether contracts for the transfer of legal entity interests may be rescinded and if so, whether the rescission will unwind the California property tax consequences triggered by the transfers. In particular, you are concerned about the creation of "original co-owner" status under Revenue and Taxation Code¹ section 64, subdivision (d) (hereafter, Section 64(d)). As explained below, it is our opinion that the transfers at issue in your case may be rescinded, and the holders of the interests in the transferee entity will no longer be original co-owners.

Facts

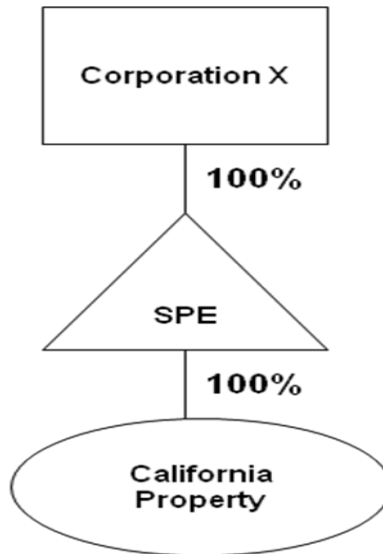
You represent the legal entities involved in the transactions described below.

Prior to October 1, 2011, Corporation X indirectly owned several parcels of California real property through wholly owned subsidiaries, special purpose entities (SPEs).² Ownership of each parcel and SPE was structured as follows:

¹ All further statutory references are to the Revenue and Taxation Code, unless otherwise specified.

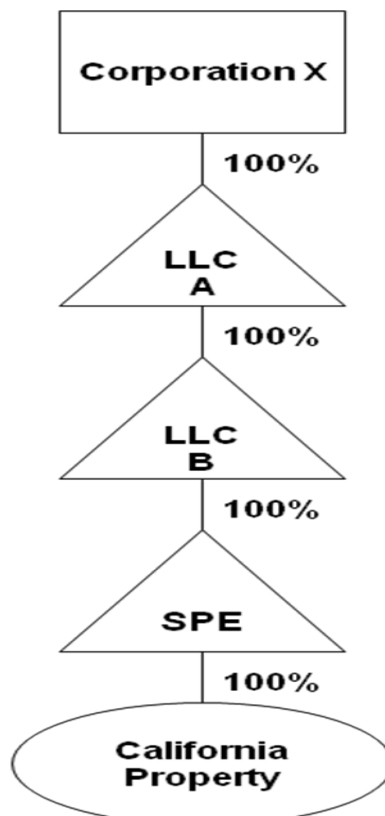
² We assume that each SPE is a limited liability company, although we note that our analysis would not differ if they were corporations instead.

As of September 30, 2011



On October 1, 2011, Corporation X assigned its interests in each SPE to another indirectly held limited liability company, Limited Liability Company B, a Delaware limited liability company (LLC B) (October 1 assignments). LLC B is wholly owned by Limited Liability Company A (LLC A), which itself is wholly owned by Corporation X. After the assignments, the ownership structure was as follows:

As of October 1, 2011



On or about November 14, 2011, Corporation X filed forms BOE-100-B, *Statement of Change in Control and Ownership of Legal Entities* (Forms BOE-100), with the Board's Legal Entity Ownership Program (LEOP), reporting the October 1 assignments. The Forms BOE-100 claimed the proportionality exclusion under Property Tax Rule 462.180, subdivision (d)(4).³

Corporation X and LLC B now desire to unwind the October 1 assignments and have mutually agreed to rescind the assignments. The intent of the parties is to return the ownership structure for several of the California properties back to the same structure that existed as of September 30, 2011 as if the October 1 assignments had never occurred. No other assignments or transfers of interests have taken place since the October 1 assignments.

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. Section 60 defines a "change in ownership" as a transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equivalent to the value of the fee interest.

Section 64, subdivision (a) provides the general rule that the transfer of ownership interests in a legal entity, such as limited liability company membership interests, does not constitute a transfer of the real property owned by the legal entity.

Under section 64, subdivision (c)(1) (hereafter, Section 64(c)(1)), when any legal entity or individual obtains a majority ownership interest in a limited liability company through the purchase or transfer of its ownership interests, that purchase or transfer causes a change in ownership of the real property owned by the limited liability company.

Section 62, subdivision (a)(2) (hereafter, Section 62(a)(2)) provides an exclusion from change in ownership for proportional ownership interest transfers of real property to or from a legal entity. Under Section 64(d), when a transfer of real property is excluded from change in ownership under Section 62 (a)(2), the holders of the legal entity interests immediately after the excluded transfer become "original co-owners" for purposes of determining the change in ownership consequences of any subsequent transfers of those legal entity interests. Property Tax Rule 462.180, subdivision (d)(4) (hereafter, Rule 462.180(d)(4)) extends the Section 62(a)(2) proportional ownership interest transfer exclusion to transfers of legal entity interests that would otherwise result in a change in control under Section 64(c)(1). Under this provision, transfers of ownership interests between legal entities or between an individual and a legal entity which result solely in a change in the method of holding title, and in which proportional ownership interests in each and every piece of real property represented by the transferred interests remain the same after the transfer, do not constitute a change in ownership of the property owned by the legal entity. However, the holders of the interests in the transferee entity become "original co-owners" for purposes of determining the change in ownership consequences of any subsequent transfers of the interests in the transferee entity. (Rule 462.180, Example 10.)

³ Cal. Code Regs., tit. 18, § 462.180, subd. (d)(4). All future references to "Rules" are to sections of title 18 of the California Code of Regulations.

As stated above, Corporation X assigned its interests in the SPEs to LLC B such that LLC B obtained 100 percent ownership of all the SPEs. This resulted in changes in control of each of the SPEs under Section 64(c)(1), which normally would result in changes in ownership of the real property held by each SPE. However, because the proportional ownership interests in each and every piece of real property remained the same before and after the transfers, the transfers were excluded under Rule 462.180(d)(4). As a result of the application of this exclusion, LLC A, as the holder of the interests in LLC B, became an original co-owner in LLC B under Rule 462.180, Example 10, for purposes of counting future transfers of LLC B interests under Section 64(d). Then, if and when LLC A would have transferred more than 50 percent of LLC B, there would have been a change in ownership of all of the real property owned by each SPE.

Your client would like to restore the ownership to the same structure that existed on September 30, 2011. Your client is concerned that, pursuant to Rule 462.180, if LLC B simply transferred the interests in each of the SPEs back to Corporation X, the transfers could result in the Corporation X shareholders becoming original co-owners of their Corporation X shares. Thus, the parties wish to rescind the October 1 assignments.

Rescission in General

Under California Civil Code section 1688, "[a] contract is extinguished by its rescission." Under Civil Code section 1689, subdivision (a), "[a] contract may be rescinded if all the parties thereto consent." In addition, under Civil Code section 1689, subdivision (b), a contract may be rescinded for various other reasons, including if the consent of any of the parties was obtained through fraud.

The rescission of a contract for the transfer of real property may "relate back" to its formation and dissolve the contract as though it had never been made. (Property Tax Annotation⁴ (Annotation) 220.0595 (January 16, 1985).) Each party to a transaction must restore, or offer to restore, to the other party all of the consideration that was received under the contract of sale, upon the condition that the other party do likewise, unless the other party is unable or positively refuses to do so. (Civ. Code, § 1691, subd. (b); Annotation 220.0595, *supra*.)

As you are aware, we have previously addressed the Proposition 13 change in ownership consequences of rescissions of contracts for the transfer of real property interests. Specifically, we have opined that the effect of such a rescission, which voids the transaction *ab initio*, is to restore the parties to the positions they held before the transfer, including restoration of the original Proposition 13 base year value of the property prior to the transfer, as if the transfer pursuant to the rescinded contract had never occurred. (Annotation 220.0598 (February 8, 2001), citing *Long v. Newlin* (1956) 144 Cal.App.2d 509 (a contract to enter into a partnership can be rescinded in the same manner and for the same reasons as other contracts).)

⁴ 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 on annotations.

We summarized the Board of Equalization's view on the change in ownership consequences of rescissions in Assessors' Handbook Section 401 (AH 401), *Change in Ownership* (September 2010), where we stated:

A transfer may be *rescinded* by the parties. That is, the parties to the transfer agree to undo the transaction and are placed in the same position in which they stood before the transfer took place. However, the original transfer remains valid until the rescission occurs.

The legal effect of a rescission is that it relates back to the creation of the deed – it is as though the transfer had never been made. When a county assessor recognizes the rescission of a transfer, the transferor's name is placed on the assessment roll as the assessee and the former base year value is enrolled on the ensuing lien date. Restoration of a base year value as a result of rescission is not subject to supplemental assessment.

(AH 401, p. 10.) (Emphasis in original.)

However, the property tax effects of a rescission of a contract for the transfer of real property can only be applied prospectively. (Annotation 220.0600 (December 11, 2003).) AH 401 explains:

[A]ny increase in the assessment prior to the rescission remains in effect until the lien date following the effective date of the rescission. Thus, a rescission is not retroactive with respect to the taxes due and owing prior to the date of rescission. There is no refund or cancellation of unpaid taxes assessed for the period prior to the rescission since property taxes are determined by the facts existing on the lien date.

(AH 401, p. 10.)

While Legal Staff has opined on the Proposition 13 consequences of rescissions of contracts for the sale of real property (Annotation 220.0598 (February 8, 2001); Annotation 220.0599 (June 29, 2001)), we have never formally opined on the Proposition 13 consequences of rescission of contracts for transfers of *legal entity interests*, as is the case in your facts.

Transfer of Legal Entity Interests

First, we must determine whether a contract for the transfer of legal entity interests is the type of contract properly subject to being rescinded under California law. The issue is whether rescission of the October 1 assignments of the *legal entity interests* in the SPEs by Corporation X to LLC B fall within the meaning of Civil Code section 1689.

There are numerous reported cases in California where the courts recognized that contracts for the sale of legal entity interests may be rescinded under Civil Code section 1689. (For example, see *Munson v. Fishburn* (1920) 18 Cal.2d 206 (where a subscription agreement for corporate stock was obtained by fraud, and where the promoters failed to reveal their own

personal interests in an investment in certain land the corporation was acquiring, the subscriber could sue under Civil Code section 1689 and was entitled to a rescission of the contract); *Prewitt v. Sunny-Mead Orchard Company* (1922) 189 Cal. 723 (shareholder could rescind the contract for her acquisition of the corporation's stock based on false representation when the corporation's officers misrepresented certain facts to her); *Vanderlip v. Los Molinos Land Company* (1943) 56 Cal.App.2d 747 (subsidiary corporation that acquired shares of its parent corporation could use Civil Code section 1689 to rescind the acquisition by mutual consent since such acquisitions were statutorily prohibited); *In Re Real Estate Associates Limited Partnership Litigation* (C.D. Cal. 2002) 223 F. Supp. 2d 1109 (upheld plaintiffs' claim for rescission under Civil Code section 1689, subdivision (b)(1), where the limited partners argued they could be adequately compensated only by the return of partnership interests transferred in a real estate investment trust transaction); and *Wood v. Apodaca* (N.D. Cal. 2005) 375 F. Supp. 2d 942 (where plaintiff contracted for the sale of interests in a partnership, plaintiff stated a proper claim for rescission under Civil Code section 1689, subdivision (b)(1), when she alleged that her consent to enter into the partnership agreement was obtained by fraud or mistake.)

Executed Contracts

Another question your facts raise is whether certain assignments, such as transfers to related parties and capital contributions, as in your case, constitute "contracts" for purposes of the Civil Code rescission provisions which allow for rescissions of contracts. Civil Code section 1040 states, "[a] voluntary transfer is an executed contract, subject to all rules of law concerning contracts in general; except that a consideration is not necessary to its validity." In our opinion, the October 1 assignments were "transfers" within the meaning of section 1040 because they were intended to pass title to interests in the SPEs. (See Civ. Code, § 1039; *Commercial Discount Co. v. Cowen* (1941) 18 Cal.2d 610; and *Driscoll v. Driscoll* (1904) 143 Cal. 528.) Using the common, ordinary meaning of the word "voluntary", in our opinion the October 1 assignments were "voluntary transfers" and therefore they were executed contracts under Civil Code section 1040, regardless of consideration. Since the assignments constituted executed contracts, Civil Code section 1689 allows for their rescission.

Result of Rescission

As with rescissions of real property transfers, the rescission of a contract for the transfer of legal entity interests voids the transactions *ab initio* as though the transfers had never been made, and restores the parties to the positions they held before the transfers being rescinded. The property tax consequence in the real property context is that the former base year value of the property prior to the transfer is restored. As detailed above, upon the consummation of the October 1 assignments, LLC A became an original co-owner of LLC B for purposes of determining future changes in ownership under Section 64(d). In your case, the consequence of the rescission is that LLC B no longer owns the SPEs, and the original co-owner status created under Rule 462.180(d)(4) is extinguished.

Section 408.1, subdivision (a) requires a legal entity to file Form 100-B with LEOP within 90 days of a change in control or change in ownership. Corporation X complied with this requirement since it filed Forms BOE-100 with LEOP on or about November 14, 2011, notifying LEOP of the changes in control of the SPEs. After completing the rescission, we recommend the filing of an amended Form BOE-100 with LEOP. Along with the amended Forms BOE-100, we

recommend that you attach a copy of the Rescission Agreement between Corporation X and LLC B, documentation of the October 1 assignments, a brief explanation of the transactions, and a copy of this opinion.

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/ Susan Galbraith

Susan Galbraith
Tax Counsel

SG/mcb

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cc:

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