

220.0671 **Step Transaction.** When, through a series of transfers, a person owning an 80 percent interest in a partnership becomes the sole owner of property formerly owned by the partnership, reappraisal of 100 percent of the property occurs pursuant to Revenue and Taxation Code section 61(i). C 6/16/94.



STATE OF CALIFORNIA

# STATE BOARD OF EQUALIZATION

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June 16, 1994

Mr. Oliver  
Executive Director  
State Board of Equalization  
450 N Street  
Sacramento, CA 95833

Dear Mr. Oliver:

This is in response to your letter of December 3, 1992, regarding the application of the step transaction doctrine to a particular situation. I apologize for the delay in responding; other matters requiring our attention have resulted in an unfortunate backlog of correspondence.

According to your letter, a partnership (A owned 80 percent interest via a trust, B owned 20 percent interest) owned a property (X). Another partnership (A owned 20 percent interest, B owned 80 percent interest) owned a property (Y). A and B decided to consolidate their interests in the properties. To do this without capital gains, A and B executed a series of transactions. First, the partnerships deeded the properties to the partners as tenants in common in proportion to their ownership interests in the partnership. Second, B transferred his 20 percent interest in X to A, and A transferred his 20 percent interest in Y to B. Now, A owns 100 percent of X, and B owns 100 percent of Y.

The assessor applied the step transaction doctrine and reassessed 100 percent of both X and Y. It is your opinion that only 20 percent of each property changed ownership. Even under the step transaction doctrine, you feel that A acquired only 20 percent of X since he already owned 80 percent of X by his interest in the partnership.

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For property tax purposes, Revenue and Taxation Code Section 60 (all statutory references are to the Revenue and Taxation Code unless otherwise indicated) defines change in ownership 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."

Section 61 reads in pertinent part:

"[e]xcept as otherwise provided in Section 62, change in ownership, as defined in Section 60, includes,...

"(e) The creation, transfer, or termination of any tenancy-in-common interest, except as provided in subdivision (a) of Section 62 and in Section 63.

"(i) The transfer of any interest in real property between a corporation, partnership, or other legal entity and a shareholder, partner, or any other person."

Section 63, interspousal transfers, does not apply to your situation. Section 62(a)(2), however, provides in relevant part that change in ownership shall 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."

In the first step the partnerships transferred each property to A and B as tenants in common with the same proportional interests as they had in the partnerships. In the second step, B transferred his 20 percent interest in X to A, and A transferred his 20 percent interest in Y to B. Now A owns 100 percent of X, and B owns 100 percent of Y. The first transaction would be excluded from change in ownership under Section 62(a)(2) as the proportional interests before and after the transfers remained the same. The second step would result in a 20 percent change in ownership for each parcel under Section 61(e).

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The assessor applied the step transaction doctrine to the transfers and reassessed both properties for a 100 percent change in ownership, you questioned whether he applied the step transaction doctrine correctly.

In light of the decision by a California Court of Appeal in Shuwa Investments Corp. v. County of Los Angeles (1991) 1 Cal.App.4th 1635, the Board's position with respect to the applicability of the step transaction doctrine as set forth in the enclosed letter to assessors 92/69, dated October 14, 1992, is summarized as follows on page 6:

"It is the position of the Board, therefore, that future step transaction decisions should be made by assessors based upon all of the facts of each transaction. If those facts demonstrate that in substance a change in ownership occurred, then the transaction should be treated accordingly. The existence of independent business purposes for the various steps will not prevent the application of the step transaction doctrine. Finally, the assessor may be aided in determining what the true substance of the transaction was by applying the (1) end result test, (2) interdependence test, and/or (3) binding commitment test, as set forth in the Shuwa decision."

The three tests were described as:

- "(1) The 'end result test' (whether the reported separate transactions were really component parts of a single transaction intended from the outset to be taken for the purpose of reaching the ultimate result).
- "(2) The 'interdependence test' (whether on a reasonable interpretation of objective facts the steps are so interdependent that the legal relations created by one transaction would have been fruitless without a completion of the series).
- "(3) The 'binding commitment test' (whether there is a binding commitment to take all steps if the first step is taken)."

If the assessor applied these tests to the facts in your situation and concluded that a step transaction occurred, then we agree with the assessor that there was a 100 percent transfer of properties X and Y. In your situation, each property transferred from the respective partnership (one partner owned 80 percent and the other owned 20 percent) to one partner. This is defined as a change in ownership under Section 61(i).

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Transactions involving legal entities result in either a 100 percent change in ownership or no change in ownership. In your situation, the substance of the transactions resulted in the properties transferring from a legal entity to an individual. Since the proportional interests changed, this resulted in a 100 percent change in ownership regardless of whether the individual was a partner in the legal entity.

I hope, however, this information has been responsive to your inquiry. If you have any further questions, please contact our Real Property Technical Services Section at (916) 445-4982.

Sincerely,

Verne Walton, Chief  
Assessment Standards Division

VW:kmc

Enclosure

(Prepared by Glenna Schultz)

bc: Mr. Richard Ochsner