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March 9, 2006

Re: Partnership Transfer / Step Transaction Doctrine

Dear Mr. _____ :

This is in response to your letter dated September 6, 2005, to Selvi Stanislaus, former Acting Assistant Chief Counsel, requesting an opinion regarding the change in ownership consequences of a series of transactions. For the reasons set forth below, it is our opinion that the S _____ Family Trusts' purchase of 50 percent property interest from the J _____ Family Trust will result in a 50 percent change in ownership of the property.

Factual Background

You have provided the following facts:

Two separate family trusts, the S _____ Family Trust and the J _____ Family Trust, are each 50 percent partners in a partnership (the Partnership). The Partnership owns a parcel of real property (property). The trustees of the S _____ Family Trust were Husband (H) and Wife (W). W died in 2003. Following W's death, the S _____ Family Trust interest in the Partnership was transferred to two trusts: 38.5 percent to the S _____ Family Trust A, a revocable trust, and 11.5 percent to the S _____ Family B Trust, an irrevocable bypass trust created by operation of law due to W's death. H is the trustee and the beneficiary of both trusts (collectively, the S _____ Family Trusts).

Subsequently, in June 2004, the Partnership was required to convey the property out of the Partnership to obtain financing. The property was conveyed 50 percent to the S _____ Family Trusts (38.5 percent to S _____ Family Trust A and 11.5 percent S _____ Family Trust B) and 50 percent to the J _____ Family Trust as tenants in common. The property remains held as tenants in common by the S _____ Family Trusts and the J _____ Family Trust. Now the S _____ Family Trusts want to purchase the property interest owned by the J _____ Family Trust.

Based on these facts, you pose the following questions:

1. Whether the transfer of the partnership interest by the S _____ Family Trust to S _____ Family Trust A and S _____ Family Trust B on the death of W qualifies for the exclusion from change in ownership under the interspousal exclusion.

2. Whether the transfer of the property by the Partnership to the S Family Trusts and the J Family Trust is excluded from reassessment under Revenue and Taxation Code section 62, subdivision (a)(2).
3. Whether there is a change in ownership when the S Family Trusts purchase the J Family Trust interest in the property.
4. Whether the step transaction doctrine applies upon the S Family Trusts' purchase of the J Family Trust's interest in the property.

Law & Analysis

A "change in ownership" is defined 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. (Rev. & Tax. Code, § 60.) A change in ownership includes, but is not limited to, the transfer of any interest in real property between a partnership and a partner. (Rev. & Tax. Code, § 61, subd. (j).) However, there is an exclusion from the definition of change in ownership for any transfer between a partnership and a partner that results solely in a change in the method of holding title to the real property and in which the proportionate ownership interests of the transferors and transferees, in each and every piece of real property transferred, remains the same. (Rev. & Tax. Code, § 62, subd. (a)(2).)

Additionally, the definition of change in ownership does not include interspousal transfers, including, but not limited to: "transfers to a trustee for the beneficial use of a spouse, or the surviving spouse of a deceased transferor, or by a trustee of such a trust to the spouse of the trustor." (Rev. & Tax. Code, § 63, subd. (a).) Furthermore, a change in ownership does not include "[t]ransfers which take effect upon the death of a spouse." (Rev. & Tax. Code, § 63, subd. (b).) Thus, the interspousal exclusion applies to transfers to trusts that benefit a spouse as well as transfers that take effect upon the death of a spouse.

1. Whether the transfer of the partnership interest by the S Family Trust to S Family Trust A and S Family Trust B on the death of W qualifies for the exclusion from change in ownership under the interspousal exclusion.

When W died, the S Family Trust transferred the partnership interest to two trusts: 38.5 percent to the S Family A Trust, a revocable trust, and 11.5 percent to the S Family B Trust, an irrevocable trust. Assuming that H was the beneficiary of S Family Trust A and the S Family Trust B, the transfer is not a change in ownership under the interspousal exclusion. (Rev. & Tax. Code, § 63, subd. (a).)

2. Whether the transfer of the property by the Partnership to the S Family Trusts and the J Family Trust is excluded from reassessment under Revenue and Taxation Code section 62, subdivision (a)(2).

Assuming that the Partnership transferred the property to the S Family Trusts and the J Family Trust as tenants in common and in proportion to their respective interests held in

the partnership, there is no change in ownership because prior to the transfer and after the transfer each partner owns exactly the same interest. (Rev. & Tax. Code, § 62, subd. (a)(2).)

3. Whether there is a change in ownership when the S Family Trusts purchases the J Family Trust interest in the property.

The S Family Trusts' purchase of 50 percent property interest from the J Family Trust will result in a 50 percent change in ownership of the property. (Rev. & Tax. Code, § 60.) Before the transaction, the S Family Trusts owned 50 percent of the property and after the transaction the S Family Trusts owns 100 percent of the property, thus, the property will be subject to a 50 percent reassessment.

4. Whether the step transaction doctrine applies upon the S Family Trusts' purchase of the J Family Trust's interest in the property.

As to the application of the step transaction, even if each of a series of transfers of real property would be excluded from a change in ownership, a transfer may be considered a single step in a series of transactions for which the application of the step transaction doctrine may apply. The step transaction doctrine allows an assessor or county assessment appeals board to disregard for tax purposes a series of steps utilized to effect the transfer of real property when the facts suggest that the transfer might have been accomplished in fewer steps and that the purpose for using a series of steps was to avoid a change in ownership. (*Shuwa Investments Corp. v. County of Los Angeles* (1991) 1 Cal. App. 4th 1635, 1648-1649.)

The step transaction doctrine may be applicable even where independent business considerations apart from the avoidance of change in ownership motivate each of the various steps. (*McMillin-BCED/Miramar Ranch North v. County of San Diego* (1995) 31 Cal.App.4th 545, 556.) An independent business reason is only one of the many factors to be considered when the form of a transaction coincides with its substance. (*Id.*) By linking together all interdependent steps, rather than taking them in isolation, tax liability may be based on a realistic view of the entire transaction. (*Commissioner v. Clark* (1989) 489 U.S. 726, 738.)

In this case, if the Partnership had transferred 100 percent of the real property directly to the S Family Trusts, rather than transferring to the S Family Trusts and the J Family Trust, then the exclusion under section 62, subdivision (a)(2) would not be applicable because the transfer would not be proportionate. The property would be subject to a 100 percent reassessment. Instead, by distributing the real property interests to the partners first in 2004, and then having the J Family Trust transfer its interest to the S Family Trusts, the partners took an additional step and utilized the section 62, subdivision (a)(2) exclusion, with the result that the S Family Trust's purchase of the J Family Trust's interest in the property would only be subject to a 50 percent reassessment. From the facts presented, it appears that the step transaction would not apply: (1) the 2004 transfer was motivated by a lender's requirement for the purpose of obtaining a loan against the property; and (2) now in 2006, the purchase is being contemplated by the S Family Trusts to purchase 50 percent interest held by the J Family Trust. However, if the assessor determines that the separate steps were all component parts of a single transaction intended to result in a transfer of a 100 percent of the property to the S Family Trusts then the assessor may apply the step transaction doctrine. Thus, the final

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determination regarding the application of the step transaction doctrine must be based upon a thorough understanding of all the surrounding facts, and rests with the assessor.

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/ Mariam Baxley

Mariam Baxley
Tax Counsel

MB:eb

Prec/Prtnrsp/06/642-mb

cc: Honorable
County Assessor

Mr. David Gau	MIC:63
Mr. Dean Kinnee	MIC:64
Ms. Mickie Stuckey	MIC:62
Mr. Todd Gilman	MIC:70