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STATE OF CALIFORNIA

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March 3, 1995

BURTON W. OLIVER
Executive Director

Attorneys

Dear Mr.

Re: Change in Ownership Implications of Proposed Real Property Transfers

Dear Mr.

Please excuse the unavoidable delay in responding to your letter of July 27, 1994 to Mr. Richard Ochsner, in which you request our opinion as to whether a change in ownership for property tax purposes would occur under three proposed transfers. You have provided the following facts for purposes of our analysis:

1. As of December 31, 1968, A and B, husband and wife, owned an undivided one-half interest in real property and improvements. Their sons, C and D, married men, each owned an undivided one-quarter interest as his separate property.
2. As if January 1, 1969, the four owners, A, B, C and D, contributed his or her interest in the property to the Partnership in exchange for ownership interests in the Partnership of 25% each.
3. A deed transferring legal title from the parties to the partnership was not executed or recorded; however, the Partnership has filed federal and state partnership income tax returns since January 1, 1969 indicating its ownership of the property.
4. The parties' ownership interests in the partnership subsequently changed, with A and B each currently owning 19.9%, C owning 30.2% and D owning 30%, due to "subsequent non-pro-rata/disproportionate contributions and withdrawals to and from the Partnership."

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You propose three transactions and would like us to confirm your analysis of the property tax implications of each.

Law and Analysis:

The general statutory provisions that apply to the facts, as described in your letter, are as follows:

As you are aware, Section 60 of the Revenue and Taxation Code² provides the basic definition of a change in ownership and states that:

A "change in ownership" means 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, subdivision (i) applies that basic definition to transfers of real property between persons and entities and states that a change in ownership shall include:

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

However, Section 62, subdivision (a)(2) provides an exclusion from the change in ownership provisions:

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 the proportional ownership interests of the transferors and transferees, whether represented by stock,

¹ These code sections are interpreted, in pertinent part, by provisions of Property Tax Rule 462, subdivision (j), (18 California Code of Regulations 462), as indicated by footnotes. A copy of these provisions is enclosed.

² Unless otherwise indicated, all section references are to the Revenue and Taxation Code.

³ Property Tax Rule 462, subdivision (a)(2).

⁴ Property Tax Rule 462, subdivision (j)(1).

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partnership interest, or otherwise, in each and every piece of real property transferred, remain the same after the transfer.⁵

A transfer of real property to a legal entity which is excluded under Section 62, subdivision (a)(2), triggers the application of Section 64, subdivision (d). That section states:

If property is transferred on or after March 1, 1975, to a legal entity in a transaction excluded from change in ownership by paragraph (2) of subdivision (a) of Section 62, then the persons holding ownership interests in such legal entity immediately after the transfer shall be considered the "original coowners." Whenever shares or other ownership interests representing cumulatively more than 50 percent of the total interests in the entity are transferred by any of the original coowners in one or more transactions, a change in ownership of that real property owned by the legal entity shall have occurred, and the property which was previously excluded from change in ownership under the provisions of paragraph (2) of subdivision (a) of Section 62 shall be reappraised.⁶

As you are aware, the provisions of Section 63.1 apply to transfers of the first \$1 million dollars in full cash value of real property between parents and their children, if in each case an "eligible transferor" transfers real property to an "eligible transferee." Per the statutory definitions, subdivision (a) of Section 63.1 provides in relevant part:

(a) Notwithstanding any other provision of this chapter, a change in ownership shall not include either of the following purchases or transfers for which a claim is filed pursuant to this section:

(1) The purchase or transfer of real property which is the principal residence of an eligible transferor in the case of a purchase or transfer between parents and their children.

⁵ Property Tax Rule 462, subdivision (j)(2)(B).

⁶ Property Tax Rule 462, subdivision (j)(4)(B).

(2) The purchase or transfer of the first one million dollars (\$1,000,000) of full cash value of all other real property of an eligible transferor in the case of a purchase or transfer between parents and their children.

(b)(1) For purposes of paragraph (1) of subdivision (a), "principal residence" means a dwelling for which a homeowner's exemption or a disabled veteran's exemption has been granted in the name of the eligible transferor. "Principal residence" includes only that portion of the land underlying the principal residence that consists of an area of reasonable size that is used as a site for the residence.

(b)(2) For purposes of paragraph (2) of subdivision (a), the one million dollar (\$1,000,000.00) exclusion shall apply separately to each eligible transferor with respect to all purchases by and transfers to eligible transferees on and after November 6, 1986, of real property, other than the principal residence of that eligible transferor.

(c) As used in this section:

(1) "Purchase or transfer between parents and their children" means either a transfer from a parent or parents to a child or children of the parent or parents or a transfer from a child or children to a parent or parents of the child or children.

And, as you noted in your letter, Subdivision (b) of Section 62 provides an exclusion for any transfer for the purpose of perfecting title to the property.⁷ See also *Parkmerced Co. v. City and County of San Francisco* (1983) 149 Cal.App.3d 1091, wherein a partner holding title to partnership property conveyed title to the partnership. In that case, the partnership's general partners were two corporations, one of the partner corporations held title to property as "nominee for the partnership," the nominee corporation subsequently merged with another corporation, and the successor corporation conveyed title to the property to the partnership. The Court held that a change in ownership within the meaning of Cal. Const., Art. XIII A, Section 2, does not occur upon the

⁷ See Property Tax Rule 462, subdivision (m).

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"transfer of bare legal title" to property, without a corresponding transfer of "the beneficial use thereof." Accordingly, the court held that the nominee corporation and its successor, following the merger, held no more than the "bare legal title" to the property for the use and benefit of the partnership, and as a matter of law, that the transfer from the successor corporation to the partnership was of its "bare legal title."

Proposal One: The parties propose to transfer legal title from themselves to the Partnership.

I. Whether the Partnership has been the beneficial owners of the real property since January 1, 1969 is a question of fact.

The parties propose to transfer legal title of the real property and improvements from themselves to the Partnership. In your view, the transfer may be excludable from change in ownership under Section 62, subdivision (b) as a transfer for the purposes of perfecting legal title.

The transfer of real property from several coowners to a partnership constitutes a change in ownership under Sections 60 and 61, unless excludable under some other code provision. Section 62, subdivision (b) would apply only if the assessor could conclude that the Partnership had the beneficial interest in the real property since January 1, 1969, in which case, the parties would be transferring only bare legal title or perfecting title. Whether the property has been Partnership property since January 1, 1969 is a question of fact, and the parties have the burden of proof.

It is the role of the Assessor to determine the sufficiency of the evidence in support of your position that the real property has been Partnership property since that date. Your facts indicate that the owners of the real property were A and B, as to an undivided one-half interest and C and D, married men, as their separate property, as to undivided one-quarter interests. Assuming that the deed to the real property states that A, B, C and D are the owners of the property, they are the owners of legal title to the property. Under Section 662 of the Evidence Code, A, B, C and D, as owners of legal title are presumed to be the owners of the full beneficial title, as well. Section 662 provides that this presumption may be rebutted "only by clear and convincing proof." Thus, the parties would have to rebut this presumption by more than just a preponderance of the evidence.

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Your facts do not indicate that A, B, C and d acquired the real property as of December 31, 1968, on behalf of the Partnership, only that they contributed their interests in the property to the Partnership as of January 1, 1969. As such, we assume that the deed by which A, B, C and D acquired the property did not contain language similar to the Parkmerced Co. documents, such as "on behalf the Partnership" and indicating title was taken "as nominee of" and "as authorized by the Partnership." We would conclude, therefore, that the Parkmerced Co. holding is not dispositive of the issue.

Your letter states that state and federal income tax forms filed on behalf of the Partnership have indicated the Partnership's ownership of the property. Presumably, the Assessor will evaluate this information, as well as other relevant facts, which may or may not support your position that the real property has been Partnership property since January 1, 1969.

If the facts establish that A, B, C and D have held only legal title to the property since January 1, 1969, and that the Partnership has been the beneficial owner of the property, then the proposed deed in which they grant the property to the Partnership should be viewed as a transfer of bare legal title under Section 62, subdivision (b) and would not constitute a change in ownership.

II. Property tax implications should the Assessor find that the real property has not been beneficially owned by the Partnership.

If the facts establish, however, that beneficial ownership of the property was not conveyed to the Partnership as of January 1, 1969, then the transfer of the property to the Partnership now would be a change in ownership under Section 61, subdivision (i), and would not be excluded from change in ownership under Section 62, subdivision (a)(2). Your facts indicate that A, B, C and D each held a 25% ownership interest in the real property; after the transfer of the property to the Partnership, and A and B each would own 19.9%, C would own 30.2%, and D would own 30% ownership interests in the Partnership. As such, the transfer would not result solely in a change in the method of holding title to the real property, and the proportionality of the partners' ownership interests "in each and every piece of real property transferred" would not remain the same after the transfer.

If the Section 62, subdivision (a)(2) exclusion is available, use of this exclusion would place the four partners

in the position of becoming "original coowners" under Section 64, subdivision (d) and Property Tax Rule 462(j)(2)(B) and for purposes of determining the change in ownership consequences of subsequent transfers of their respective partnership interests. Thus, if and when those original coowners, A, B, C, and D cumulatively transfer ownership interests in the Partnership of more than 50%, the real property which would have been excluded from the change in ownership provisions by Section 62, subdivision (a)(2), would undergo a change in ownership of the total property, requiring a 100% reappraisal for property tax purposes.

Proposal Two: A and B will deed to their sons, C and D, fractional ownership interests in the real property. The ownership interests in the real property will then be as follows; A and B will each own a 19.9% interest, C will own 30.2% and D will own 30%. They will subsequently transfer their ownership interests in the property to the Partnership, and receive ownership interests in the Partnership in the same proportion as their interests in the real property were before the transfer of real property to the Partnership.

I. Parents' real property transfer to sons excluded from change in ownership under Section 63.1.

For this proposal, we assume that the Partnership has not been the beneficial owner of the real property as in Proposal One, and that A, B, C and D are the owners of both beneficial and legal title. As you are aware, A and B's transfer of portions of the real property to their sons, C and D, could be excluded from change in ownership under Section 63.1 (to the extent the full cash value limitation is not exceeded),⁸ and the subsequent transfer of real property from A, B, C and D to the Partnership would be excluded from change in ownership under Section 62, subdivision (a)(2).

II. Application of Step-Transaction Doctrine to Parent-Child Transfers.

⁸ Section 63.1 subdivision (a)(2)) excludes from change in ownership the first million dollars of full cash value for real property other than the eligible transferors' principal residence. Section 63.1 (b)(2) provides that the one million dollars exclusion applies separately to each eligible transferor, permitting each parent to transfer real property valued at that amount.

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You have requested that we confirm your position that the "step transaction doctrine", will not be applied to the two transfers discussed above. As you are aware, the "step transaction doctrine" has been applied to property tax transfers when unnecessary steps are taken merely to circumvent the intent of the change in ownership statutes; in which case, the "substance of the transaction, rather than the form" will determine if a change in ownership has actually occurred. (*Shuwa Investment Corp. v. County of Los Angeles* (1991) 1 Cal.App.4th 1635). See also LTA No. 92/69, October 14, 1992, enclosed.

In the proposed transfer, A and B would first transfer fractional interests in the real property to their sons, C and D, followed by the four owners transferring their respective ownership interests in the property to the partnership. Thus, A and B would take two steps to accomplish what is really a one-step transaction of transferring their interest in the property to the partnership while retaining some ownership interests and transferring some ownership interests to their sons. The one-step transaction would constitute a change in ownership of the entire property. (Section 60, Section 61, subdivision (i)). As you are aware, where unnecessary steps are taken to transfer real property, the step-transaction analysis may be triggered.

However, the Legislature has created an exception to the rule that substance over form controls in order to preserve the benefit of the parent/child exclusion in certain situations. The legislative intent regarding the application of the step transaction doctrine to certain transfers is specifically addressed in Section 2 of Chapter 48 of the Statutes of 1987. Section 2 states in pertinent part that:

"...it is the intent of the Legislature that the provisions of Section 63.1 of the Revenue and Taxation Code shall be liberally construed in order to carry out the intent of Proposition 58 on the November 4, 1986, general election ballot to exclude from change in ownership purchases or transfers between parents and their children described therein....Further, transfers of real property between eligible transferors and eligible transferees shall also be fully recognized when the transfers are immediately followed by a transfer from the eligible transferee or eligible transferees to a corporation, partnership, trust, or other legal entity where the transferee or transferees are the sole owner or

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owners of the entity or are the sole beneficial owner or owners of the property, if the transfer between eligible transferors and eligible transferees satisfies the requirements of Section 63.1. Except as provided herein, nothing in this section shall be construed as an expression of intent on the part of the Legislature disapproving in principle the appropriate application of the substance-over-form or step-transaction doctrine." (emphasis added).

Based on the foregoing, it has been our position that an exception to the step transaction doctrine exists where qualified transfers are made in order to take advantage of the parent-child exclusion. While the quoted language describes a situation which closely parallels the transfers described herein, there is an important distinction. That is, Section 2 refers to a qualifying parent-child transfer of real property from parents to their children, followed by a transfer of the real property to a legal entity wherein the eligible transferees (ie. children) are the sole owners of the entity.

In the instant case, A and B's transfer of fractional ownership interests in the real property to their sons, C and D, followed by a transfer by the parties of their respective ownership interests in the real property to the partnership, which is wholly owned by both parents and children, (is not solely owned by eligible transferees) does not fall within the express language of Section 2 of Chapter 48. Nevertheless, we have, in the past, concluded that since only parents and children are involved in these situations, the transfers do fall within the limits of the expressed intention of the Legislature and that the step transaction doctrine would not apply. While we reach the same conclusion here, please be advised that the question is not free of doubt. It is quite possible that an assessor could reach the opposite view relying on the specific language of Section 2.

Proposal Three: A and B will execute, deliver and record deeds conveying fractional interests in the real property to their sons, C and D. The ownership interests in the property will be as follows: A 19.9%, B 19.9%, C 30.2%, D 30%.

You ask whether the transfer of real property would be excluded from change in ownership under Section 63.1. Please see the discussion pertaining to Proposal Two, supra.

The views expressed in this letter are, of course, only advisory in nature. They are not binding upon the assessor of any county. You may wish to consult the Sonoma County

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Assessor's Office in order to confirm that the described property will be assessed in a manner consistent with the conclusions stated above.

Our intention is to provide courteous and helpful responses to inquiries such as yours. Suggestions that help us to accomplish this goal are appreciated.

Very truly yours,

A handwritten signature in cursive script that reads "Mary Ann Alonzo".

Mary Ann Alonzo
Staff Counsel

MAA:jd
precednt/parchild/95005.maa

Enclosures

cc: Honorable James J. Gallagher
Sonoma County Assessor
Mr. John W. Hagerty, MIC:63
Mr. Richard Johnson, MIC:64
Ms. Jennifer Willis, MIC:70

ANNOTATION

CHANGE IN OWNERSHIP

Parent-Child. Section 2, Chapter 48 of the Statutes of 1987 expressly provided that transfers of real property between eligible transferors (parents) and eligible transferees (children) are excluded from change in ownership when the transfers are immediately followed by a transfer from the eligible transferee(s) to a partnership or other legal entity where the transferee(s) are the sole owner(s) of the entity or are the beneficial owner(s) of the property, if the transfer satisfies the requirements of Section 63.1.

Following a parent-child transfer of real property and a subsequent transfer of the real property to a legal entity composed of transferee children and parents, such a transfer to the legal entity may fall within the protection of Section 2 from application of the step-transaction doctrine, but the conclusion is not free of doubt. C 3/3/95.