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STATE BOARD OF EQUALIZATION

1000 N STREET, SACRAMENTO, CALIFORNIA  
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)  
(916) 324-6594

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October 6, 1987

Dear Mr.

This is in response to your letter to Mr. Richard Ochsner dated September 22, 1987 in which you request our opinion that the following transactions described in your letter are excluded from a change in ownership under Revenue and Taxation Code\* section 63.1.

TRANSACTION A:

Husband and wife [hereinafter referred to as "H" and "W"], own all of the capital common stock in Corporation A, as community property. Corporation A was formed in 1987, at which time an unimproved parcel of real property was transferred to Corporation A by H and W in exchange for all of the Corporation A common stock. This is the only real property in Corporation A. Its original cost was \$200,000.00, and its estimated fair market value at the date of transfer was \$350,000.00. Construction of a building of a value of approximately \$3,000,000.00 is contemplated in the very near future. The subject real property is located in Santa Clara County, California, and was owned by H and W as community property, for at least two (2) years prior to its transfer to Corporation A.

H and W intend to transfer all of the stock in Corporation A to an independent trustee. Four (4) separate trusts will be created, one for each of the four (4) children of H and W as the sole beneficiary, said trusts designed to meet the requirements of a minor's trust under section 2503(c) of the Internal Revenue Code. The trust provisions will provide that the trustee may distribute all income from the

\*All statutory references are to the Revenue and Taxation Code unless otherwise indicated.

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property in the trustee's discretion to the child, but shall otherwise accumulate it for the child and make the trust property available to the child upon the attainment of age 21, and in any event, upon attainment of age 28, when the trust is to terminate with the child being the sole beneficiary. If the child predeceases distribution, the property may be appointed by the child's Will or Codicil, and failing such testamentary disposition, the property will be distributed to the other child's estate. Each of the said four (4) children were born of H and W referred to herein, as defined in section 63.1(c)(2)(A) of the Revenue and Taxation Code.

ANALYSIS:

When H and W transferred real property which they owned as community property to Corporation A in exchange for all of the common stock of Corporation A which they own as community property, the transfer was excluded from change in ownership under section 62(a)(2) because it resulted "solely in a change in the method of holding title to the real property and 'was one' in which proportional ownership interests . . . represented by stock . . . remain[ed] the same after the transfer."

As a result of that transaction, husband and wife became "original coowners" as defined in section 64(d).

Section 64(c) provides in relevant part that "[w]hen a corporation, partnership, other legal entity or any other person obtains control, as defined in section 25105, in any corporation . . . through the purchase or transfer of corporate stock, . . . such purchase or transfer of such stock . . . shall be a change of ownership of property owned by the corporation . . . in which the controlling interest is obtained." Section 25105 defines control as "[d]irect or indirect ownership or control of more than 50 percent of the voting stock of the" corporation.

Section 64(d) provides in relevant part that "[w]henver 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 . . . 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.

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"A transfer of shares . . . which results in a change in control of a corporation . . . is subject to reappraisal as provided in subdivision (c) rather than this subdivision."

Under the foregoing provisions, a transfer of all the stock in Corporation A to an independent trustee will result in a change in ownership of the real property owned by Corporation A unless section 63.1 is applicable.

You quote the following language from section 2 of Chapter 48 of the Statutes of 1987 in support of your contention that the foregoing transaction is excluded from change in ownership under Revenue and Taxation Code section 63.1:

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 wherein the transferee or transferees are the sole owner or 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.

We do not believe the proposed transfer satisfies the requirements of section 63.1. Section 63.1, which was added to the Revenue and Taxation Code by Chapter 48 of the Statutes of 1987, provides in 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 principle residence of an eligible transferor in the case of a purchase or transfer between parents and their children.

(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.

Section 63.1(c)(6) provides that "'[r]eal property' means real property as defined in section 104. Real property does not

include any interest in a legal entity." (Emphasis added.) The foregoing provision makes it clear that only purchases or transfers of real property and not interests in a legal entity are eligible for exclusion from change in ownership under section 63.1. Accordingly, since the transfer intended is of common stock which is an interest in a legal entity and not real property, section 63.1 is not applicable and the transfer is not excluded from change in ownership under section 63.1.

TRANSACTION B:

H and W presently own real property which is improved with a commercial building leased to various tenants, which property cost was approximately \$650,000.00, and which property has been held by H and W for a period in excess of two (2) years, and which property has a present estimated fair market value in excess of \$1,000,000.00. The subject real property is located in Santa Clara County, California. H and W intend to transfer the said real property to Corporation B (which corporation is different than the corporation referred to as Corporation A above), all of the stock of which is contemplated to be owned as community property by H and W. Upon completion of the transfer of the real property to Corporation B, and within a short time thereafter during the year 1987, it is contemplated that H and W will give all of the shares of Corporation B to the trustee referred to above, one-fourth (1/4) each in the separate trusts for each of the four (4) children of H and W described in Transaction A above.

ANALYSIS:

The only significant factual difference between Transactions A and B is that Transaction B involves an existing building leased to various tenants.

Under the one-owner rule (sections 61(c) and 62(g)), the lessee is deemed to be the owner of the leased real property if the remaining term of the lease is 35 years or more including renewal options and the lessor is deemed to be the owner if the remaining term of the lease is less than 35 years including renewal options.

Thus, to the extent that the leases in question have a remaining term of less than 35 years including renewal options, the lessors H and W are deemed to be the owner's of the real

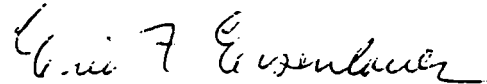
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property in question and the result of the intended transfer of shares of common stock of Corporation B is identical to that in Transaction A. However, to the extent that the leases in question have a remaining term of 35 years or more including renewal options, the lessors H and W are not deemed to be the owners of the real property in question and the intended transfer of shares of common stock in Corporation B would not result in a change in ownership to that extent.

The views expressed in this letter are, of course, advisory only and are not binding upon the assessor of any county. You may wish to consult the appropriate assessor in order to confirm that the described property will be assessed in a manner consistent with the conclusions stated above.

If we can be of further assistance in this matter, please let us know.

Very truly yours,



Eric F. Eisenlauer  
Tax Counsel

EFE:cb  
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cc: Honorable Alfred E. Carlson  
Santa Clara Assessor